# 92-2252

| | | | |
|---|---|---|---|
| A | AGP AND CO INC | 10Q | 03-31-92 |
| B | ALFA INTERNATIONAL CORP | 10Q | 03-31-92 |
| C | COLUMBUS ENERGY CORP | QA | 02-29-92 |
| D | HARRELL INTERNATIONAL INC | 10Q | 12-31-90 |
| E | HART HOLDING CO INC | 10Q | 03-29-92 |
| F | HILLS BANCORPORATION | 10Q | 03-31-92 |
| G | PETER KIEWIT SONS' INC | 10Q | 03-31-92 |
| H | LAFAYETTE AMERICAN BANCORP INC | 10Q | 03-31-92 |
| I | MEDI-MAIL INC | QA | 03-31-92 |
| I | MEDI-MAIL INC | 10Q | 03-31-92 |
| J | MERCANTILE BANKSHARES CORP | 10Q | 03-31-92 |
| K | NATIONAL REHABILITATION CENTERS INC | 10Q | 03-31-92 |
| L | NDE ENVIRONMENTAL CORP | 10Q | 03-31-92 |
| M | NEW EAST BANCORP | 10Q | 03-31-92 |
| N | OESI POWER CORP | 10Q | 03-31-92 |
| O | OUTBACK STEAKHOUSE INC | 10Q | 03-31-92 |
| P | OXFORD HEALTH PLANS INC | 10Q | 03-31-92 |
| Q | PHASE-OUT OF AMERICA INC | 10Q | 03-31-92 |
| R | TREATS INTERNATIONAL ENTERPRISES INC | 10Q | 03-31-92 |

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SECURITIES AND EXCHANGE COMMISSION
Washington, D C 20549

## FORM 10-Q

## QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the quarter ended March 31, 1992 Commission file number 33-8191 DC

AGP and Company Inc.
(formerly Asset Growth Partners Inc.)

(Exact Name of Registrant as specified in its charter)

New Jersey
(State of Incorporation)

22-2669811
(I.R.S. Employer Identification No.)

650 Fifth Avenue, New York, New York 10019
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including Area Code: (212) 246-6370

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES X NO ____

The number of shares of each of the registrant's classes of common stock, as of March 31, 1992 is 5,555,969 shares, all of one class of no par value Common Stock.

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# AGP and Company Inc.

## FORM 10-Q

## FOR THE QUARTER ENDED MARCH 31, 1992

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PART I - FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

## AGP AND COMPANY INC.
## CONSOLIDATED BALANCE SHEETS

| | March 31, 1992 (unaudited) | Dec. 31, 1991 |
|---|---|---|
| **ASSETS** | | |
| Current | | |
| Cash | $121,175 | $468,569 |
| Accounts Receivable, net | 1,994,701 | 3,262,001 |
| Inventory | 2,566,009 | 2,531,188 |
| Other Current Assets | 339,363 | 238,798 |
| Total Current Assets | 5,021,248 | 6,500,556 |
| Property and Equipment, Net | 1,983,967 | 1,984,524 |
| Restricted Securities | 108,746 | 108,746 |
| Intangible Assets | 390,530 | 437,846 |
| Other Noncurrent Assets | 295,644 | 127,340 |
| Total Assets | $7,800,135 | $9,159,012 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Current Portion of Long-Term Debt | $712,984 | $714,154 |
| Accounts Payable | 940,423 | 704,110 |
| Accrued Expenses | 867,867 | 1,171,339 |
| Deferred Income Taxes | 14,300 | 14,300 |
| Total Current Liabilities | 2,535,574 | 2,603,903 |
| Long Term Debt | 3,268,114 | 4,643,890 |
| Deferred Income Taxes | 62,400 | 62,400 |
| Minority Interest | 335,000 | 320,000 |
| SHAREHOLDERS' EQUITY: | | |
| Common Stock, no par value ; 19,999,000 shares authorized; 5,555,969 issued at 12/31/91 and 3/31/92 | 784,309 | 784,309 |
| Retained Earnings | 824,738 | 754,510 |
| | 1,609,047 | 1,538,819 |
| less: Treasury Stock ,at cost, 10,000 shares | (10,000) | (10,000) |
| Total Shareholders' Equity | 1,599,047 | 1,528,819 |
| Total Liabilities & Shareholder's Equity | $7,800,135 | $9,159,012 |

See accompanying notes to consolidated financial statements

# AGP AND COMPANY INC.
## CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
## THREE MONTHS ENDED MARCH 31,

| | 1992 | 1991<br>(as restated) |
|---|---|---|
| Fee Income | $416,649 | $301,335 |
| Product Income | 2,420,832 | 2,684,336 |
| Total Revenue | 2,837,481 | 2,985,671 |
| Cost of Product Sales | 1,607,404 | 1,744,819 |
| Operating Expenses | | |
| Fee Income | 314,922 | 238,708 |
| Product Sales | 627,608 | 596,742 |
| Depreciation and Amortization | 44,544 | 37,333 |
| Operating Income | 243,003 | 368,069 |
| Interest Expense | (116,269) | (130,959) |
| Other Income | 2,494 | 1,211 |
| Income before Provision for Income Taxes, Minority Interest, and Cumulative Effect of Change in Accounting Principle | 129,228 | 238,321 |
| Provision for Income Taxes | 44,000 | 86,000 |
| Minority Interest | 15,000 | |
| Income before Cumulative Effect of Change in Accounting Principle | 70,228 | 152,321 |
| Cumulative Effect of Change in Accounting Principle | | 47,900 |
| Net Income | 70,228 | 200,221 |
| Net Income per Common and Common Equivalent Shares: | | |
| Income before Cumulative Effect of Change in Accounting Principle | $0.01 | $0.03 |
| Cumulative Effect of Change in Accounting Principle | | 0.01 |
| Net Income | $0.01 | $0.04 |
| Weighted Average Common and Common Equivalent Shares Outstanding | 5,555,969 | 5,455,969 |

See accompanying notes to consolidated financial statements

## AGP AND COMPANY INC.
## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
## THREE MONTHS ENDED MARCH 31,

| | 1992 | 1991<br>(as restated) |
|---|---|---|
| Cash Flows from Operating Activities | | |
| Net Income | $70,228 | $200,221 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities Operating Activities: | | |
| Depreciation and Amortization | 163,121 | 130,611 |
| Cumulative Effect of Change in Accounting Principle | | (47,900) |
| Financing Costs | 12,785 | (148,853) |
| Minority Interest | 15,000 | |
| Changes in Assets and Liabilities: | | |
| Accounts Receivable | 1,267,300 | 610,436 |
| Other Current Assets | (100,565) | 51,486 |
| Inventory | (34,821) | (304,677) |
| Accounts Payable and Accrued Expenses | (67,159) | (54,206) |
| Other Noncurrent Assets | (168,305) | |
| Total Adjustments | 1,087,356 | 236,897 |
| Net Cash Provided by Operating Activities: | $1,157,584 | $437,118 |
| Cash Flows From Investing Activities: | | |
| Capital Expenditures | (128,032) | (40,902) |
| Net Cash Used in Investing Activities | (128,032) | (40,902) |
| Cash Flows From Financing Activities: | | |
| Payments on Notes Payable and Long-term Debt | (1,376,946) | (858,311) |
| Net Cash Used in Financing Activities | (1,376,946) | (858,311) |
| Net Decrease in Cash and Cash Equivalents | (347,394) | (462,095) |
| Cash and Cash Equivalents at Beginning of Period | 468,569 | 527,839 |
| Cash and Cash Equivalents at End of Period | $121,175 | $65,744 |
| Cash Paid for: | | |
| Interest | 105,890 | 140,539 |
| Income Taxes | 43,000 | 2,425 |

See accompanying notes to consolidated financial statements

# AGP AND COMPANY INC.
## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

### NOTE 1 - CONSOLIDATED FINANCIAL STATEMENTS:

The unaudited consolidated financial statements of AGP and Company Inc. and subsidiaries as of March 31, 1992 and 1991, and for the three month periods then ended reflect, in the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to fairly state the results of operations for interim periods. The year end balance sheet data was derived from audited financial statements but does not include all disclosures required by generally accepted accounting principles. The unaudited consolidated interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 1991 which are included in the Company's 10-K filing dated April 14, 1992.

### NOTE 2 - INCOME TAXES:

In December 1991, the Company adopted Financial Standard No. 109, Accounting for Income Taxes retroactive to January 1, 1991. The cumulative effect of this change in accounting for income taxes increased 1991 net income by $47,900 or $.01 per share. The first quarter 1991 earnings have been restated for the effect of this change.

### NOTE 3 - OTHER FINANCIAL STATEMENT INFORMATION

The following provides additional information concerning selected balance sheet information:

| | March 31<br>1992<br>(unaduited) | December 31<br>1991 |
|---|---|---|
| Accounts receivable net: | | |
| Accounts receivable | $2,046,159 | $3,313,001 |
| Allowance for doubtful accounts | 51,458 | 51,000 |
| | $1,994,701 | $3,212,001 |
| Inventories: | | |
| Finished goods | $1,437,675 | $1,422,611 |
| Work in Process | 406,694 | 630,251 |
| Raw materials and supplies | 721,640 | 478,326 |
| | $2,566,009 | $2,531,188 |
| Property and Equipment: | | |
| Land | $ 40,000 | $ 40,000 |
| Building and improvements | 653,025 | 653,025 |
| Furniture and equipment | 2,338,243 | 2,218,851 |
| Leasehold improvements | 61,980 | 53,340 |
| | $3,093,248 | $2,965,216 |

## NOTE 3 - OTHER FINANCIAL STATEMENT INFORMATION con't.

| | | |
|---|---|---|
| Less accumulated depreciation and amortization | 1,109,281 | 980,692 |
| | $1,938,967 | $1,984,524 |
| Intangible assets | | |
| Non-compete agreement | $ 533,000 | $ 533,000 |
| Other | 274,054 | 286,838 |
| | 807,054 | 819,839 |
| Less accumulated amortization | 416,524 | 381,992 |
| | $ 390,530 | $ 437,846 |
| Accrued Expenses: | | |
| Compensation | $ 268,011 | $ 440,008 |
| Income Taxes | 319,601 | 273,100 |
| Commissions | 15,017 | 161,090 |
| Royalties | 25,177 | 104,547 |
| Other | 240,061 | 192,594 |
| | $ 867,867 | $1,171,339 |

## ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Results of Operations

The Company derives revenues from fee income for providing investment banking services to middle market companies through its subsidiary Asset Growth Partners, Inc. and from the sale of manufactured storage cases to retailers nationwide through its subsidiary Dynasound Organizer, Inc. ("DOI") and its subsidiary Dynasound Manufacturing, Inc. ("DMC").

### Comparison of the Three Months Ended March 31, 1992 with the Three Months Ended March 31, 1991

For the three months ended March 31, 1992, the Company's consolidated revenues were $2,837,481. Consolidated operating income was $243,003 or 8.6% of net revenue and net income was $70,228 or 2.5% of net revenue. The results were influenced by a higher level of activity by Asset Growth Partners, Inc. and a lower level of activity of the Dynasound business.

### Revenues

The consolidated net revenues of the Company for 1992 were $2,837,481 compared with $2,985,671 for 1991. The decrease of $148,190 is attributable to a decrease of $263,506 for the product business offset by an increase of $115,314 in the fee business. The product business has declined slightly due to the weak retail economy while the fee business has shown strong growth. Management believes that the product business while begin to grow and that the fee business will continue its growth trend throughout the balance of 1992.

Fee income from investment banking activities during 1992 was $416,649 an increase of $115,314 from the fee income of $301,335 recorded for the period ended March 31, 1991, or an increase of 38%. This increase is attributable to a strong demand for investment banking services from the middle-market business sector.

Revenues from the Dynasound business for the three months ended March 31, 1992 were $2,420,832 as compared with $2,684,336 for the three months ended March 31, 1991. The decrease of $213,504, or a decrease of 8% is attributable to a weak economy and a delay in the production of new molded products.

### Operating Costs and Expenses

Cost of product sales were $1,607,404 for the three month period ended March 31, 1992 as compared to $1,744,819 for the three month period ended March 31, 1991. Gross profit margin on Dynasound sales were 34% and 35% for the periods ended March 31, 1992 and 1991 respectively. This decrease in gross profit margin from 1991 to 1990 is primarily attributable to (i) greater product mix in the fabric segment which historically has sold at lower profit margins, (ii) and general weakness in the retail business, and (iii) expanded sales in the licensed product segment which has a lower margin due to the underlying royality arrangements than the nonlicensed product segment. The company expects that its gross profit margin will return to historical levels in the succeeding periods of 1992.

## Operating Costs and Expenses con't.

Fee income operating expenses increased by $76,214 from $238,708 for 1991 to $314,922 for 1992. The increase was attributable to an increase in commissions paid as well as an increase in fixed operating costs.

Product operating expenses were $627,608 and $596,742 respectively for the three months ended March 31, 1992 and 1991. These operating expenses have approximated at 26% and 22% of net revenues for those periods respectively. These costs, some of which are variable, have increased primarily as a result of the personnel required to handle the growth at Dynasound.

## Operating Income

Operating income for the Company decreased by $125,066 from $368,069 in 1991 to $243,003 in 1992 or 34%. This decrease is primarily a result of decrease profitability at Dynasound over the comparative period for reasons described above.

## Interest Expense

Interest expense decreased from $130,959 in 1991 to $116,269 in 1992, a decrease of $14,690. This decrease is attributable to a lower interest rate environment offset in part by greater amounts of debt required to finance the Company's operations.

## Income Taxes

Income tax expense declined from 36% of pretax income in 1991 to 34% of pretax income in 1992. The decline is primarily a result of a lower income tax rate on income attributable to the Puerto Rican subsidiary.

In December 1991, the Company adopted Financial Accounting Standard No. 109, Accounting For Income Taxes, retroactive to January 1, 1991. The cumulative effect of this change in accounting for income taxes increased 1991 net income by $47,900. The first quarter 1991 earnings have been restated for the effect of this change.

## Minority Interest

Minority interest of $15,000 was recorded for the period ended March 31, 1992 as a result of the Dynasound Organizer warrants discussed in Note 9 to the December 31, 1991 financial statements.

## Net Income

Net income decreased by $129,993 from $200,221 in 1991 to $70,228 in 1992 or a decrease of 65%. The decrease is attributable to the reasons described above.

## LIQUIDITY AND CAPITAL RESOURCES

During the current period through March 31, 1992, revenues and profits from AGP, the Dynasound Organizer business and its related financing, has significantly increased the liquidity, capital resources, and working capital of the Company. As of March 31, 1992 and December 31, 1991, the company had working capital of $2,485,674 and $3,896,653.

The Company believes at March 31, 1992 it has adequately reserved for exposures related to credit risk and credit adjustments. Historically, Dynasound bad debt write-offs have been less than 1% of sales. Such write-offs are not expected to be significant in the future.

In February 1991, Dynasound refinanced its senior debt with Norwest Bank N.A. ("Norwest") that included (a) a revolving credit facility of $3,000,000; (b) a fixed asset term loan of $625,000; (c) a cash flow term loan of $750,000. As part of the refinancing, the Company paid $250,000 to Norwood which reduced the amount of indebtedness to $500,000. In addition, as part of the Company's original agreement with Norwood, the Company redeemed 16.6% of Norwood's warrants that are exercisable into Dynasound common stock. In December 1991, the Norwest revolving credit facility was increased from $3,000,000 to $5,000,000. Additionally, in December 1991, the Company financed the purchase of equipment with Norwest for $120,000. In March 1992, the Company financed the purchase of equipment with Norwest for $72,500.

Management believes it has adequate working capital to sustain existing operations and meet debt service requirements for the ensuing 12 months.

## IMPACT OF INFLATION AND OTHER FACTORS

Management of the Company believes that the impact of inflation generally has not had an effect upon the amount of capital generally available for the purpose of investment. To the extent that inflation decreases the amount of available investment capital, investment banking business of the Company may be effected. The very nature of the business of the Company and its industry in general is directly effected by national and international economic and political conditions, broad trends in business and finance and volatility of interest rates, changes in and uncertainty regarding tax laws, and the securities market generally. Recent events in both the national and international business climate markets, make it difficult to predict an overall effect of such events upon the Company's anticipated future operations.

Management does not believe that the Dynasound operation are significantly impacted by inflation, as it is anticipated that sales price increases would offset any increase in operating costs. A significant portion of Dynasound's debt has variable interest rates, however, and an increase to the prime rate would directly impact interest expense.

Management does not believe the litigation currently outstanding involving the Company and its president as defendants or the current preliminary environmental investigation matter will have a material adverse effect on the financial position of the Company.

## PART II

## OTHER INFORMATION

### ITEM 1

### LEGAL PROCEEDINGS

NONE

### ITEM 2

### CHANGES IN SECURITIES

NONE

### ITEM 6

### EXHIBITS

(22) Subsidiaries of Registrant.

### REPORTS ON FORM 8-K

None required to be filed.

## EXHIBIT 22 - SUBSIDIAIRES OF REGISTRANT

| | |
|---|---|
| Dynasound Organizer, Inc. | (Delaware) |
| Asset Growth Partners, Inc. | (Delaware) |
| Asset Growth Partners, Inc. | (Delaware) |

## SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

DATED: May 15, 1992

AGP & COMPANY, INC.

By: Joseph W. McSherry
Chief Financial Officer

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# FORM 10-Q

## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended: March 31, 1992

**ALFA International Corp.**
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **New Jersey**<br>(State or other jurisdiction of incorporation or organization) | **22-2216835**<br>(I.R.S. Employer Identification Number) |

**27 Warren Street, Hackensack, New Jersey**
(Address of principal executive offices)

**07601**
(Zip Code)

**(201)487-2134**
Registrant's telephone number, including area code

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check number whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___

As of March 31, 1992, the registrant had outstanding 6,545,006 shares of Common Stock, par value $.01 per share.

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# ALFA INTERNATIONAL CORP.

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DECEMBER 31, 1991
MARCH 31, 1992

STATEMENTS OF OPERATIONS

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THREE MONTHS ENDED MARCH 31, 1991

STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

THREE MONTHS ENDED MARCH 31, 1992

STATEMENTS OF CASH FLOWS

THREE MONTHS ENDED MARCH 31, 1992
THREE MONTHS ENDED MARCH 31, 1991

NOTES TO FINANCIAL STATEMENTS

ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### PART II - OTHER INFORMATION

ITEM 6: EXHIBITS AND REPORT ON FORM 8 -K ALFA INTERNATIONAL CORP.

# ALFA INTERNATIONAL CORP. AND SUBSIDIARIES
## CONSOLIDATED BALANCE SHEETS

| ASSETS | March 31, 1992 (Unaudited) | December 31, 1991 (Note 1) |
|---|---|---|
| **CURRENT ASSETS:** | | |
| Cash and equivalents | $ 40,262 | $ 97,050 |
| Accounts receivable-trade less allowance for doubtful accounts of $27,394 in 1992 and $57,631 in 1991 | 77,160 | 129,727 |
| Inventories: | | |
| Work-in-process | 83,698 | 89,840 |
| Finished goods | 152,127 | 186,170 |
| Prepaid advertising | 42,713 | 58,793 |
| Prepaid artwork | 24,351 | 37,723 |
| Prepaid expenses and other current assets | 15,454 | 17,164 |
| Total Current Assets | 435,765 | 616,467 |
| **PROPERTY AND EQUIPMENT:** | | |
| Machinery and equipment | 49,375 | 48,962 |
| Furniture and fixtures | 27,121 | 27,121 |
| | 76,496 | 76,083 |
| Less: Accumulated depreciation | 48,538 | 45,190 |
| | 27,958 | 30,893 |
| **NET NON-CURRENT ASSETS OF DISCONTINUED OPERATIONS** | 138,262 | 109,664 |
| | $ 601,985 | $ 757,024 |

| LIABILITIES AND STOCKHOLDERS' EQUITY | March 31, 1992 (Unaudited) | December 31, 1991 (Note 1) |
|---|---|---|
| **CURRENT LIABILITIES:** | | |
| Accounts payable - trade: | | |
| Trade creditors | $ 452,111 | $ 421,544 |
| Accrued expenses and other current liabilities | 37,594 | 53,833 |
| Net current liabilities of discontinued operations | 316,563 | 250,272 |
| Total Current Liabilities | 806,268 | 725,649 |
| **STOCKHOLDERS EQUITY:** | | |
| Undesignated preferred stock: | | |
| Authorized - 978,400 shares | | |
| Issued and outstanding - none | | |
| Series A preferred stock - $.01 par value: | | |
| Authorized, issued and outstanding 21,600 shares at stated liquidation value | 648,000 | 648,000 |
| Common Stock - $ .01 par value | | |
| Authorized - 15,000,000 shares | | |
| Issued - 6,545,006 shares | 65,450 | 65,450 |
| Capital in excess of par value | 2,273,955 | 2,273,955 |
| Retained earnings (deficit) | (3,191,688) | (2,956,030) |
| Total Stockholder's Equity | (204,283) | 31,375 |
| | $ 601,985 | $ 757,024 |

## ALFA INTERNATIONAL CORP. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | THREE MONTHS ENDED MARCH 31 | |
|---|---|---|
| | 1992 | 1991 |
| **REVENUES:** | | |
| Net sales | $ 186,950 | $ 269,893 |
| Interest income | - | 15,103 |
| Other income | - | 3,541 |
| | 186,950 | 288,537 |
| **COST AND EXPENSES:** | | |
| Cost of sales | 132,077 | 127,162 |
| Selling,general and administrative | 255,155 | 318,028 |
| Interest expense | - | 782 |
| | 387,232 | 445,972 |
| **LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES** | (200,282) | (157,435) |
| **INCOME TAXES (CREDITS):** | | |
| Federal | - | - |
| State | - | 13 |
| | - | 13 |
| **LOSS FROM CONTINUING OPERATIONS** | $(200,282) | $(157,448) |
| **DISCONTINUED OPERATIONS:** | | |
| Loss from operations | ( 74,389) | - |
| Gain estimated on disposal, including a provision for operating losses during phase out period | 39,013 | - |
| | ( 35,376) | - |
| **NET LOSS** | $ (235,658) | $ (157,448) |
| **WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING** | 6,545,006 | 5,984,125 |
| **NET INCOME (LOSS) PER SHARE** | $ ( 0.04) | $ ( 0.03) |

## ALFA INTERNATIONAL CORP. AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

| | Preferred Stock | | Common Stock | | Capital in Excess of Par Value | Retained Earnings (Deficit) |
|---|---|---|---|---|---|---|
| | Shares | Stated Value | Shares | Par Value | | |
| BALANCE AT DECEMBER 31, 1991 | 21,600 | $648,000 | 6,545,006 | $65,450 | $2,273,955 | $(2,956,030) |
| Net (loss) for the Three Months ended March 31, 1992 | - | - | - | - | - | (235,658) |
| BALANCE AT MARCH 31, 1992 | 21,600 | $648,000 | 6,545,006 | $65,450 | $2,273,955 | $(3,191,688) |

# ALFA INTERNATIONAL CORP. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | Three Months Ended March 31, | |
|---|---|---|
| | 1992 | 1991 |
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | |
| Net income (loss) | $ (235,658) | $( 157,448) |
| Adjustments to reconcile net income (loss) to net cash flows from operating activities: | | |
| Depreciation and amortization | 3,348 | 2,667 |
| Provision for losses on accounts receiveable | - | - |
| Provision for doubtful note receiveable from director/stockholder | - | - |
| Other | - | - |
| Changes in operating assets and liabilities: | | |
| Accounts receivable - trade | 52,567 | 22,985 |
| Inventories | 40,185 | ( 6,172) |
| Prepaid expenses and other assets | 31,162 | (83,627) |
| Net non-current assets of discontinued operations | (28,598) | - |
| Accounts payable-trade creditors | 30,565 | 79,611 |
| Accounts payable-banker's acceptances | | ( 210) |
| Income taxes payable | | |
| Accrued expenses and other current liabilities | ( 16,239) | ( 10,165) |
| Net current liabilities of discontinued operations | 66,291 | - |
| Net cash flows from operating activities | ( 56,375) | (152,359) |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | |
| Net changes in certificated of deposit and commercial paper | - | 900,000 |
| Acquisitions of property and equipment | ( 413) | ( 2,329) |
| Net change in stockholder receivable | - | ( 999) |
| Investment in acquisition of Nieman | - | (632,759) |
| Net cash flows from investing activities | ( 413) | 263,913 |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | |
| Net borrowings under line-of-credit | - | - |
| Net cash flows from financing activities | - | - |
| **NET CHANGE IN CASH AND EQUIVALENTS** | (56,788) | 111,554 |
| **CASH AND EQUIVALENTS, BEGINNING OF PERIOD** | 97,050 | 20,133 |
| **CASH AND EQUIVALENTS, END OF PERIOD** | $ 40,262 | $ 131,687 |
| **SUPPLEMENTAL CASH FLOW INFORMATION:** | | |
| Income taxes paid (refunded) | - | - |
| Interest paid | $ - | $ 782 |

# ALFA INTERNATIONAL CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

### NOTE 1 - BASIS OF PRESENTATION:

All financial statements are unaudited. In the opinion of management, all adjustments which include only normal recurring adjustments necessary to present fairly the financial position, results of operations and changes in financial position for all periods presented have been made. The results of operations for interim periods are not necessarily indicative of operating results for the full year. The company presently has two wholly-owned subsidiaries, TY-BREAKERS Corp. which operates its custom and retail apparel business and Nieman Machine Company which is presently being liquidated. All significant intercompany transactions have been eliminated in their consolidation with the company.

Footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted in accordance with the published rules and regulations of the Securities and Exchange Commission. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's annual report on Form 10-K.

### NOTE 2 - MANAGEMENT'S PLAN TO OVERCOME OPERATING AND LIQUIDITY DIFFICULTIES:

Basis of Presentation - The Company has had operating losses from continuing operations during the three years and five months ended December 31, 1991 and the three months ended March 31, 1992, and a substantial loss in 1991 relating to discontinued operations, resulting in significant cash flow and liquidity problems at December 31, 1991 and March 31, 1992.

The financial statements of the Company have been prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. Accordingly, the financial statements do not include any adjustments relating to the recoverability of recorded asset amounts for continuing operations or the amount and classification of liabilities that might be necessary should the Company be unable to continue in the normal course of business.

Management's Plans - Since February 1992, the Company has been actively attempting to resolve problems with Nieman, including winding up operations and eliminating costs. Over the next several months, alternative use of Nieman's facility is expected. Cash resulting from the liquidation of Nieman is expected to provide liquidity for the next few months.

The Company is attempting to obtain debt or equity capital which is needed to expand its imprinted apparel line. These additional lines which would include non-Tyvek apparel are expected to increase sales and, hopefully, achieve ultimate profitability. The Company is presently in discussions with interested parties but it is not possible at this time to ascertain if additional capital

## NOTE 2 - MANAGEMENT'S PLAN TO OVERCOME OPERATING AND LIQUIDITY DIFFICULTIES (continued):

can be obtained.

In addition to attempting to increase sales through an expanded product line, the Company is attempting to control costs where possible. Through these measures, management is hopeful that continuing operations can be brought into profitability. However, if these measures are unsuccessful, the Company may be unable to continue in business.

Reference should be to "Management's Discussion and Analysis of Financial Condition and Results of Operations" for additional information.

## ALFA INTERNATIONAL CORP. AND SUBSIDIARIES

Item 2. Management discussion and analysis of financial condition and results of operations.

### RESULTS OF OPERATIONS:

### THREE MONTHS ENDED MARCH 31, 1992 vs. THREE MONTHS ENDED MARCH 31, 1991

Net sales revenue decreased by approximately $ 83,000 during the first quarter of 1992 compared to the first quarter of 1991. This decrease was principally due to decreases in export sales of $69,000, commission revenue from the sale of export products of $44,000 and sales of custom TYVEK® products of $37,000 which were partially offset by retail sales of TYVEK® products of $66,428 which were first introduced during the second quarter of 1991. Sales revenue for the first quarter of 1992 was further negatively impacted by the Company's liquidity problems which prevented shipment of approximately $250,000 of backlog orders during the quarter. Cost of sales increased by approximately $4,900 during the first quarter of 1992 compared to the first quarter of 1991 principally due to the decrease in 1992 of custom TYVEK® sales and the commission revenue on export products in 1991.

Selling, general and administrative expenses decreased by $58,000 during the first quarter of 1992 compared to the first quarter of 1991. This was because of the Company's previously implemented cost control measures.

The net loss of the Company increased by approximately $78,000 during the first quarter of 1992 compared to the first quarter of 1991. This increase was mainly attributable to the decrease in revenues resulting from the Company's inability to ship its backlog of orders and a net loss of $35,000 from discontinued operations.

### LIQUIDITY AND CAPITAL RESOURCES:

The Company had a working capital deficit of ($327,420) at March 31, 1992 as compared to a deficit of ($109,182) at December 31, 1991. This represents a increase of $218,238 and is primarily attributable to the Company's losses for the period.

The continuing TY-BREAKERS business has not operated profitably and is not operating profitable at the present time despite significant reductions in operating expenses. The Company is presently negotiating with the creditors of Nieman and liquidating Nieman's assets. It is too early to predict what amount of cash will be generated from the liquidation of Nieman's assets. The Company is also holding discussions with several parties regarding the private placement sale of its Common Stock and/or debt, but no assurance can be given at this time that these discussions will be successful. Projected revenues in 1992 for TY-BREAKERS are expected to be greater than 1991 but these projected 1992 sales levels can only be attained if the Company is successful in obtaining additional financing. Additional reductions in operating expenses as well as a capital infusion will be required to allow the business to continue operations. If the need arises and the Company is unable to secure new capital or debt financing, or if the proceeds from the liquidation of Nieman are insufficient, the Company may seek to reorganize under protection of Chapter 11 of the Federal Bankruptcy Act.

## PART II - OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORT ON FORM 8 - K.

(A) EXHIBITS

NONE

(B) REPORTS ON FORM 8 - K

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: 5/19/92

ALFA INTERNATIONAL CORP.
(Registrant)

By: ______________________
Frank J. Drohan
Chief Executive Officer,
and Chief Financial Officer

MANUALLY SIGNED

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Commission File No. 1-9872

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# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

## FORM 8

## AMENDMENT TO APPLICATION OR REPORT

Filed pursuant to Section 12, 13, or 15(d) of

The Securities Exchange Act of 1934

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COLUMBUS ENERGY CORP.
(Exact name of Registrant as specified in charter)

AMENDMENT NO. 1

The undersigned Registrant hereby amends the following items, financial statements, exhibits or other portions of its Quarterly Report for February 29, 1992 on Form 10-Q as set forth in the pages attached hereto:
(List all such items, financial statements, exhibits or other portions amended)

| | |
|---|---|
| Financial Statements: | |
| Balance Sheet - Liabilities and Stockholder's Equity | p. 4 |
| Consolidated Statement of Stockholders' Equity | p. 6 |
| Note (7) - Common Stock Subject to Redemption | p. 13 |
| Management's Discussion and Analysis of Financial Condition and Results of Operations | p. 15 |

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Q-Data Corp. - St. Petersburg, FL

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this amendment to be signed on its behalf by the undersigned thereunto duly authorized.

COLUMBUS ENERGY CORP.
(Registrant)

Date May 14, 1992

By Ronald H. Beck
(Signature)
Ronald H. Beck
Vice President and Treasurer

## COLUMBUS ENERGY CORP.

## CONSOLIDATED BALANCE SHEETS

## LIABILITIES AND STOCKHOLDERS' EQUITY

| | February 29, 1992 (unaudited) | November 30, 1991 |
|---|---|---|
| | (in thousands) | |
| Current liabilities: | | |
| Current maturities of long-term debt (Note 3) - bank debt | $ 465 | $ 529 |
| Accounts payable | 668 | 770 |
| Undistributed oil and gas production receipts | 1,185 | 1,141 |
| Accrued production and property taxes | 219 | 905 |
| Prepayments from joint interest owners | 339 | 409 |
| Accrued expenses | 309 | 318 |
| Other (Note 2) | 257 | 250 |
| Total current liabilities | 3,442 | 4,322 |
| Long-term debt (excluding current maturities) (Note 3): | | |
| Bank debt | 3,031 | 3,189 |
| Employee stock ownership plan | 574 | 596 |
| Capital lease obligations | 40 | 51 |
| Deferred income taxes (Note 4) | 162 | 144 |
| Other liabilities | 222 | 219 |
| Common stock subject to redemption, 229,232 shares (Note 7) | 1,203 | - |
| Commitments and contingent liabilities (Notes 2 and 3) | | |
| Stockholders equity: | | |
| Preferred stock authorized 5,000,000 shares, no par value, none issued | - | - |
| Common stock authorized 20,000,000 shares of $.20 par value; shares issued 2,957,542 in 1992, of which 229,232 shares are subject to redemption, and 2,927,542 in '991 (outstanding 2,957,542 in 1992 and 2,927,542 in 1991) | 546 | 586 |
| Additional paid-in capital | 11,178 | 12,026 |
| Cumulative foreign currency translation adjustments | (313) | (189) |
| Accumulated deficit, since December 1, 1987 | (2,737) | (3,066) |
| | 8,674 | 9,357 |
| Less: Stock held by Employee Stock Ownership Plan | (574) | (596) |
| Total stockholders' equity | 8,100 | 8,761 |
| | $ 16,774 | $ 17,282 |

The accompanying notes are an integral part of these financial statements.

# COLUMBUS ENERGY CORP.
## CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
For the Three Months Ended February 29, 1992
(Unaudited)

(dollar amounts in thousands)

| | Common Stock | | Additional Paid-In Capital | Accumulated Deficit | Foreign Currency Translation Adjustments | Employee Stock Ownership Plan |
|---|---|---|---|---|---|---|
| | Shares | Amount | | | | |
| Balances, December 1, 1991 | 2,927,542 | $ 586 | $12,026 | $(3,066) | $ (189) | $ (596) |
| Exercise of employee stock options | 30,000 | 6 | 163 | | | |
| Adjustment for foreign currency translation | - | - | - | - | (124) | - |
| Contributions to Employee Stock Ownership Plan | - | - | - | - | - | 22 |
| Income tax benefit of loss carryforwards arising prior to quasi-reorganization | - | - | 146 | - | - | - |
| Net earnings | - | - | - | 329 | - | - |
| Common stock subject to redemption | - | (46) | (1,157) | - | - | - |
| Balances, February 29, 1992 | 2,957,542 | $ 546 | $11,178 | $(2,737) | $ (313) | $ (574) |

The accompanying notes are an integral part of these financial statements.

In February 1992, the Financial Accounting Standards Board issued Statement No. 109 - Accounting for Income Taxes - which will require the Company to change its method of reporting for income taxes for financial statement purposes no later than fiscal year 1994. The Company has not determined the potential impact of such change, if any, on its financial statements.

## (5) RELATED PARTY TRANSACTIONS

The general and administrative cost reimbursements from CPS and COP will continue at a minimal level until Columbus completes its activities as liquidator thereof. Columbus received from COP fees and reimbursements (included with operating and management services revenue) of $3,000 and $5,000 for the three months ended February 29, 1992 and February 28, 1991, respectively.

## (6) LITIGATION EXPENSE

The litigation expense in the first quarter of 1992 includes (1) the $50,000 of CGS Creditors' Trust expenses which Columbus has agreed to pay in connection with the Settlement Agreement that was executed on March 18, 1992, and (2) $40,000 for the estimated costs of registration of the 1,029,232 shares to be distributed or sold by the Trust as part of that Agreement.

## (7) COMMON STOCK SUBJECT TO REDEMPTION

Pursuant to the terms of the Settlement Agreement related to the Civil Action and Adversary Proceeding, Columbus is obligated to purchase, at $5.25 per share, any of the 229,232 common shares not purchased by third parties on or before June 15, 1992. The total amount of $1,203,468 has been classified separately from stockholders' equity until such time that the amount of shares, if any, purchased by Columbus is known. The amount of shares purchased by third parties will then be reclassified as part of stockholders' equity.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

Add and insert the following after the third sentence in the first full paragraph of page 15:

> To the extent that cash is used to purchase treasury stock working capital and liquidity will be decreased unless bank debt repayments are also reduced or a new expanded loan is obtained and utilized. In any event the Company's liquidity will still be sufficient to provide funds for development activities in 1992.

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C.

# FORM 10-Q

## QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended December 31, 1990 Commission File No.: 0-2661

Harrell International, Inc.
(Exact name of registrant as specified in its charter)

Delaware
(State of jurisdiction)

13-1946181
(I.R.S. Employer Identification No.)

17218 Preston Road, Suite 425, Dallas, TX 75252
(Address of principal executive offices)

(214) 250-6370
(Registrant's telephone no., including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

(1) Yes X No ____
(2) Yes X No ____

The number of shares outstanding of the registrant's Class A, $.01 par value common stock as of January 31, 1991, was 485,380 (as adjusted to give effect to the Restructuring Agreement dated December 23, 1991 - see Subsequent Events discussion in the registrant's Form 10-K report for the fiscal year ended September 30, 1990, which is incorporated herein by this reference).

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# HARRELL INTERNATIONAL, INC.

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements.

## HARRELL INTERNATIONAL, INC.
## CONDENSED BALANCE SHEETS

| | December 31, 1990 (Unaudited) | September 30, 1990 (Audited) |
|---|---|---|
| **ASSETS** | | |
| Current Assets: | | |
| Cash | $ 3,571 | $ 46,538 |
| Prepaid expenses | - | 2,181 |
| Total current assets | 3,571 | 48,719 |
| Furniture and equipment, at cost less accumulated depreciation | 1,215 | 1,693 |
| Total | $ 4,786 | $ 50,412 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)** | | |
| Current Liabilities: | | |
| Accounts payable and accrued liabilities | $ 25,484 | $ 12,145 |
| Stockholders' equity (deficit): | | |
| Common Stock: | | |
| Class A $.01 par value, 9,000,000 shares authorized, 485,380 issued and outstanding | 4,854 | 4,854 |
| Class B $.01 par value, 1,000,000 shares authorized | - | - |
| Additional paid-in capital | 1,929,540 | 1,929,540 |
| Deficit | (1,955,092) | (1,896,127) |
| Total stockholders' equity (deficit) | (20,698) | 38,267 |
| Total | $ 4,786 | $ 50,412 |

# HARRELL INTERNATIONAL, INC.
## STATEMENTS OF OPERATIONS
(Unaudited)

| | Three Months Ended December 31 | |
|---|---|---|
| | 1990 | 1989 |
| Revenues: | | |
| Interest income | $ 180 | $ 20,662 |
| General and administrative expenses | 59,145 | 82,989 |
| Income (loss) before income taxes | (58,965) | (62,327) |
| Provision for income taxes | - | - |
| Net income (loss) | $ (58,965) | $ (62,327) |
| Net income (loss) per share | $(.12) | $(.14) |
| Weighted average shares outstanding | 485,380 | 435,380 |

## HARRELL INTERNATIONAL, INC.
## CONDENSED STATEMENTS OF CASH FLOWS
## (Unaudited)

| | Three Months Ended December 31 | |
|---|---|---|
| | 1990 | 1989 |
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | |
| Net income (loss) | $ (58,965) | $ (62,327) |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Loss on disposal of furniture and equipment | 478 | - |
| (Increase) decrease in receivables | - | 145,489 |
| (Increase) decrease in prepaid expenses | 2,181 | (5,271) |
| Increase (decrease) in accounts payable | 13,339 | (22,738) |
| Net cash provided (used) by operating activities | (42,967) | 55,153 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | |
| Payments received on notes receivable | - | 1,758,640 |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | |
| Dividends paid | - | (870,760) |
| Reduction in retirement liability | - | (900,000) |
| Net cash used by financing activities | - | (1,770,760) |
| **NET INCREASE (DECREASE) IN CASH** | (42,967) | 43,033 |
| **CASH AT BEGINNING OF PERIOD** | 46,538 | 565,229 |
| **CASH AT END OF PERIOD** | $ 3,571 | $ 608,262 |

## HARRELL INTERNATIONAL, INC.
## NOTES TO CONDENSED FINANCIAL STATEMENTS

### 1. PRINCIPLES OF DISCLOSURE

The balance sheet as of December 31, 1990, and the related statements of income and cash flows for the three month periods ended December 31, 1990 and 1989, are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of such financial statements have been included. Such adjustments consisted only of normal recurring items. Interim results are not necessarily indicative of results for a full year.

The financial statements and notes are presented as permitted by Form 10-Q, and do not contain certain information included in the Registrant's annual financial statements and notes.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

### Material Changes in Financial Condition.

Harrell International, Inc. (the "Company") consummated a recapitalization on August 28, 1990, and paid a special dividend on September 5, 1990, of $482,793 to the Company's stockholders of record on June 29, 1990. This transaction substantially reduced the Company's liquid assets and other capital resources and effectively terminated its pre-existing operations.

The Company entered into a joint venture agreement dated December 7, 1990, with Riviera Investors Corporation, a Texas Corporation ("RIC"), forming the "Riviera Joint Venture." RIC contributed $232,000 to the venture's capital. Although the Company contributed no cash to the venture, Clover, Inc., then the controlling shareholder of the Company, in exchange for good and valuable consideration, assigned to the venture its rights under that certain Contract of Sale dated October 20, 1990, by and between Clover, Inc. and the Estate of James Devereaux Stahlman.

The venture exercised its rights under the Contract of Sale on December 7, 1990, and purchased a 37 unit apartment complex known as Riviera Apartments (the "Riviera Project") located in Dallas, Texas, for a purchase price of $222,000.

Pursuant to the Riviera Joint Venture Agreement, the venture's distributable cash is to be distributed as follows:

(1) The first $32,480 to RIC;
(2) The second $32,480 to the Company;
(3) The balance, 50% to RIC and 50% to the Company.

While RIC and the Company share equally the venture's management, the Company supervises its day-to-day operations. The Riviera Project is managed by an unrelated third party.

Wilson L. Harrell, a director of the Company, is the president of Riviera Investors Corporation. Mr. Harrell and Arthur Linkletter, also a director of the Company, contributed $51,000 and $58,000, respectively, to RIC's capital and Irvin Atkins, Douglas C. Echols, Mr. Harrell's brother-in-law, and David A. Woodcock, Jr., contributed $58,000, $50,000 and $15,000, respectively. These amounts entitled those persons to the following shares and percentage ownership in RIC:

|  |  |  |
|---|---|---|
| Wilson L. Harrell | 510 shares | 21.98% |
| Arthur G. Linkletter | 580 shares | 25.00% |
| Irvin Atkins | 580 shares | 25.00% |
| Douglas C. Echols | 500 shares | 21.55% |
| David A. Woodcock, Jr. | 150 shares | 6.47% |

In order to induce Messrs. Atkins, Echols and Woodcock to invest in RIC, the Company granted them options to buy one fourth of a share of the Company's common stock for each dollar invested for a purchase price of $1.00 per share. Accordingly, Messrs. Atkins, Echols and Woodcock were issued options to purchase 14,500, 12,500, and 3,750 shares of the Company's common stock, respectively. The options were issued as of December 7, 1990, and expire December 6, 1993.

## Material Changes in Results of Operations.

The Company's pre-existing operations were effectively terminated in the final quarter of fiscal 1990. Although the Company began to shift its operational focus in the current period to real estate ventures, the Company did not receive revenues from such operations by the current reporting period's end. Consequently, the Company's only revenue for the quarter ended December 31, 1990, was $180 of interest income. Despite the change in operations, the Company continued to incur general and administrative expenses which totaled $59,145, producing a net loss of $58,965 for the period.

## Part II. OTHER INFORMATION

### Item 1. Legal.

There were no material legal proceedings, either on-going, instituted by or against, or otherwise involving the Registrant during the quarter ended December 31, 1990.

### Item 2. Change in Securities.

There has been no change in the Registrant's securities during the quarter ended December 31, 1990.

### Item 3. Defaults Upon Senior Securities.

The Registrant does not have any outstanding debt or securities of this nature.

### Item 4. Submission of Matters to a Vote of Security Holders.

The Registrant did not submit any matters to a vote of the security holders during the quarter ended December 31, 1990.

### Item 5. Other Information.

None.

### Item 6. Exhibits and Reports.

(a) No events occurred during the quarter ended December 31, 1990, which require the submission of an exhibit.

(b) No reports on Form 8-K were filed by the Registrant for the quarter ended December 31, 1990.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HARRELL INTERNATIONAL, INC.

By:
Wilson L. Harrell, President

Dated: June 13th 1992

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ITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

# FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 29, 1992

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition period from ________ to ________

Commission file number 0-11427

**HART HOLDING COMPANY INCORPORATED**

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 23-1467390 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |
| 1120 Boston Post Road<br>Darien, Connecticut | 06820 |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code: (203) 655-6855

Common stock, par value $.01 per share

(Title of class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ___

12,901,516 shares of $.01 par value common stock of the Registrant were outstanding at the close of business on May 8, 1992.

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## HART HOLDING COMPANY INCORPORATED AND SUBSIDIARIES

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

### CONDENSED CONSOLIDATED BALANCE SHEET
HART HOLDING COMPANY INCORPORATED AND SUBSIDIARIES
(In thousands)

| | December 31, 1991 | March 29, 1992 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | $ 20,995 | $ 41,864 |
| Receivables, net of allowance for doubtful accounts | 41,449 | 43,718 |
| Inventories - Note A | 39,510 | 41,234 |
| Deferred income taxes | 4,198 | 2,341 |
| Prepaid and other current assets | 3,005 | 3,304 |
| Current investment in discontinued operations - Note B | 15,823 | 788 |
| TOTAL CURRENT ASSETS | 124,980 | 133,249 |
| PROPERTY, PLANT AND EQUIPMENT | | |
| Cost | 63,060 | 63,419 |
| Less accumulated depreciation | 26,397 | 27,357 |
| | 36,663 | 36,062 |
| OTHER ASSETS AND DEFERRED CHARGES | | |
| Unamortized financing costs, less accumulated amortization of $5,722 and $5,997 | 3,386 | 3,111 |
| Goodwill, less accumulated amortization of $6,877 and $7,228 | 48,073 | 47,722 |
| Other assets and deferred charges | 737 | 774 |
| Noncurrent investment in discontinued operations - Note B | 3,296 | 2,927 |
| | 55,492 | 54,534 |
| TOTAL ASSETS | $217,135 | $223,845 |

CONDENSED CONSOLIDATED BALANCE SHEET (Continued)
HART HOLDING COMPANY INCORPORATED AND SUBSIDIARIES
(In thousands, except share data)

| | December 31, 1991 | March 29, 1992 |
|---|---|---|
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Revolving loans payable to banks | $ 30,000 | $ 30,000 |
| Current portion of long-term debt | 43 | 31 |
| Accounts payable | 15,851 | 18,986 |
| Accrued expenses | 21,655 | 27,158 |
| Current Liabilities related to discontinued operations - Note B | 4,835 | 7,307 |
| TOTAL CURRENT LIABILITIES | 72,384 | 83,482 |
| LONG-TERM DEBT - Note C | 118,917 | 118,958 |
| DEFERRED INCOME TAXES | 2,554 | 2,559 |
| MINORITY INTEREST | 1,331 | 1,268 |
| LONG-TERM LIABILITIES RELATED TO DISCONTINUED LIABILITIES - Note B | 4,666 | 1,250 |
| TOTAL LIABILITIES | 199,852 | 207,517 |
| SHAREHOLDERS' EQUITY | | |
| Common Stock, 40,000,000 shares authorized, 16,073,037 and 16,033,209 shares issued and 12,976,142 and 12,936,314 shares outstanding | 161 | 160 |
| Additional paid-in capital | 15,034 | 14,858 |
| Retained earnings | 3,661 | 5,025 |
| Equity adjustments from translation | 4,419 | 2,277 |
| Common Stock held in treasury, at cost, 3,096,895 shares | (5,992) | (5,992) |
| | 17,283 | 16,328 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | $217 135 | $223,845 |

See notes to condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENT OF INCOME
HART HOLDING COMPANY INCORPORATED AND SUBSIDIARIES
(In thousands)

| | Quarter Ended | |
|---|---|---|
| | March 31, 1991 | March 29, 1992 |
| Net sales | $61,626 | $66,375 |
| Cost of sales | 49,657 | 52,832 |
| Gross profit on sales | 11,969 | 13,543 |
| Selling, general and administrative expenses | 7,616 | 7,345 |
| Operating income | 4,353 | 6,198 |
| Other income (expense): | | |
| Other income, net | 366 | 192 |
| Interest expense and amortization of financing costs and debt discounts | (5,113) | (4,829) |
| | (4,747) | (4,637) |
| (Loss) income before income taxes and minority interest | (394) | 1,561 |
| Income tax (benefit) provision | (666) | 111 |
| Minority interest | (16) | (86) |
| Net Income | $ 256 | $ 1,364 |

See notes to condensed consolidated financial statements.

## CONDENSED CONSOLIDATED STATEMENT OF INCOME (Continued)
## HART HOLDING COMPANY INCORPORATED AND SUBSIDIARIES

(In thousands, except per share data)

| | Quarter Ended | |
|---|---|---|
| | March 31, 1991 | March 29, 1992 |
| Earnings per share (Exhibit 11): | | |
| Income per common and common equivalent share: | | |
| Primary: | | |
| Net Income | $ .02 | $ .09 |
| Fully diluted: | | |
| Net Income | $ .02 | $ .09 |
| Weighted average number of common shares outstanding: | | |
| Primary | 15,201 | 15,157 |
| Fully Diluted | 15,201 | 15,157 |

See notes to condensed consolidated financial statements.

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## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
## HART HOLDING COMPANY INCORPORATED AND SUBSIDIARIES
(In thousands)

| | Common Stock Par Value $.01 | | Additional Paid-in Capital | Retained Earnings | Translation Adjustments | Common Stock Held in Treasury | | Total |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | | | | Shares | Amount | |
| Balance at December 31, 1991 | 16,073 | $ 161 | $ 15,034 | $ 3,661 | $ 4,419 | 3,097 | $(5,992) | $ 17,283 |
| Purchase and cancellation of Common Stock | (40) | (1) | (176) | | | | | (177) |
| Net income | | | | 1,364 | | | | 1,364 |
| Translation adjustments | | | | | (2,142) | | | (2,142) |
| Balance at March 29, 1992 | 16,033 | $ 160 | $ 14,858 | $ 5,025 | $ 2,277 | 3,097 | $(5,992) | $ 16,328 |

See notes to condensed consolidated financial statements.

## CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
## HART HOLDING COMPANY INCORPORATED AND SUBSIDIARIES

(In thousands)

| | Quarter Ended | |
|---|---|---|
| | March 31, 1991 | March 29, 1992 |
| **OPERATING ACTIVITIES** | | |
| Net income | $ 256 | $ 1,364 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 2,055 | 2,366 |
| Change in minority interest | (302) | (63) |
| Changes in operating assets and liabilities, net of discontinued operations | 668 | 6,180 |
| Translation adjustments | (1,267) | (1,314) |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES** | 1,410 | 8,533 |
| **INVESTING ACTIVITIES** | | |
| Proceeds from the disposal of discontinued operations, net of transaction costs paid | 1,074 | 14,460 |
| Purchases of property, plant, and equipment | (2,207) | (1,933) |
| **NET CASH (USED) PROVIDED BY INVESTING ACTIVITIES** | (1,133) | 12,527 |
| **FINANCING ACTIVITIES** | | |
| Principal payments on long-term debt | (13) | (15) |
| Purchase and retirement of stock | (6) | (176) |
| Other, net | 101 | - |
| **NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES** | 82 | (191) |
| **INCREASE IN CASH AND CASH EQUIVALENTS** | 359 | 20,869 |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD** | 22,058 | 20,995 |
| **CASH AND CASH EQUIVALENTS AT END OF PERIOD** | $ 22,417 | $ 41,864 |

See notes to condensed consolidated financial statements.

# NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
# HART HOLDING COMPANY INCORPORATED AND SUBSIDIARIES

MARCH 29, 1992

## GENERAL

Hart Holding Company Incorporated ("Hart Holding" or "the Company") is a diversified industrial company engaged in two business segments through its 93.5% owned subsidiary Reeves Industries, Inc. ("Reeves Industries"). Reeves Industries' principal asset is the capital stock of its wholly-owned subsidiary, Reeves Brothers, Inc. ("Reeves"). Reeves is a diversified industrial company with operations in two business segments: industrial coated fabrics and apparel textiles. The Industrial Coated Fabrics Group manufactures and sells rubber and synthetic coated fabrics such as offset printing blankets, truck tarpaulins, gaskets, gas meter and other molded and flat diaphragms, materials used in automotive airbags and graphic arts products for industrial applications. The Apparel Textile Group manufactures, processes and sells specialty textile fabrics to apparel and other manufacturers.

Effective December 31, 1991, Hart Holding exchanged its 1,000 shares of Reeves Industries' Series I Preferred Stock, par value $1.00 per share, stated value $5,001,000 and having a liquidation value of $9,410,000 for 18,820,000 shares of Reeves Industries Common Stock. This transaction resulted in Hart Holding's percentage ownership in Reeves Industries Common Stock increasing from 86.7% to 93.5%.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. For such information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 1991, as filed with the Securities and Exchange Commission on March 30, 1992. The condensed consolidated financial statements so presented are in the opinion of management, inclusive of all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of financial position as of March 29, 1992, and the results of operations and cash flows for the quarters ended March 31, 1991 and March 29, 1992.

MARCH 29, 1992

## NOTE A - INVENTORIES

Inventories at December 31, 1991 and March 29, 1992, are comprised of the following (in thousands):

| | December 31, 1991 | March 29, 1992 |
|---|---|---|
| Raw materials | $ 8,001 | $ 8,354 |
| Work in progress | 10,092 | 10,531 |
| Finished goods | 21,417 | 22,349 |
| | $39,510 | $41,234 |

Approximately 26% and 30% of the Company's inventories at December 31, 1991 and March 29, 1992, respectively, are valued using the last-in, first-out ("LIFO") method. Interim LIFO determinations, including those as of March 29, 1992, are based on management's estimates of expected year end inventory levels and costs.

## NOTE B - DISCONTINUED OPERATIONS

As of December 31, 1991, the Company revalued its reserves with respect to the disposal of the ARA Automotive Group and as a result adjusted the loss with respect to the discontinuance of ARA, which occurred in the fourth quarter of 1990, downward from $34.6 million to $32.2 million, net of applicable income tax benefits of $19.5 million and $18.0 million, respectively. This resulted in a gain of $2.4 million in the fourth quarter of 1991, net of applicable income taxes of $1.4 million.

The assets and liabilities and the results of operations of the ARA Automotive Group have been accounted for as discontinued operations in the accompanying condensed consolidated financial statements. Revenues from the discontinued operations amounted to $5,910,000 and $0 during the quarters ended March 31, 1991 and March 29, 1992, respectively.

The investment in discontinued operations reflected in the December 31, 1991 and March 29, 1992 Condensed Consolidated Balance Sheet is comprised of the following (in thousands):

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
## HART HOLDING COMPANY INCORPORATED AND SUBSIDIARIES

MARCH 29, 1992

| | December 31, 1991 | March 29, 1992 |
|---|---|---|
| Cash | $ 4 | $ - |
| Accounts receivable | 1,035 | 725 |
| Other current assets | 50 | - |
| Property, plant and equipment, net | 19 | - |
| Income tax receivable | 15,021 | - |
| Deferred income taxes | 2,990 | 2,990 |
| Total investment in discontinued operations | $19,119 | $ 3,715 |

### NOTE C - LONG-TERM DEBT

Long-term debt at December 31, 1991 and March 29, 1992, consisted of the following (in thousands):

| | December 31, 1991 | March 29, 1992 |
|---|---|---|
| 12 1/2% Senior Notes of Reeves Industries due May 1, 1996, net of unamortized discount of $223 and $200 | $ 49,457 | $ 49,480 |
| 13% Senior Subordinated Debentures of Reeves Industries due May 1, 1998, net of unamortized discount of $411 and $394 | 53,589 | 53,606 |
| 13 3/4% Subordinated Debentures of Reeves Industries due May 1, 2001, net of unamortized discount of $148 and $144 | 15,852 | 15,856 |
| Other | 62 | 47 |
| | 118,960 | 118,989 |
| Less current portion | (43) | (31) |
| | $118,917 | $118,958 |

In March 1992, Reeves Industries and the agent for the banks that are party to the Reeves Industries Loan Agreement (the "Loan Agreement"), agreed to an amendment (the "Amendment") to the Loan Agreement.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
HART HOLDING COMPANY INCORPORATED AND SUBSIDIARIES

MARCH 29, 1992

Concurrent with the consummation of the Amendment, Reeves Industries paid, out of available funds, the $30.0 million Revolving Loan outstanding as of December 31, 1991 which was due March 31, 1992. The Amendment makes available to Reeves a maximum revolving loan capacity of $20.0 million (as amended, the "Reeves Revolving Loan"). A letter of credit facility is available to Reeves of up to $5.0 million. The aggregate amount of the Reeves Revolving Loan outstanding plus outstanding letters of credit cannot exceed the lesser of $20.0 million or the Borrowing Base, as defined by the Amendment. The Reeves Revolving Loan due date is the earlier of the date Reeves Industries completes a refinancing or January 29, 1993. The Reeves Revolving Loan bears interest at: prime plus 1 3/4% or LIBOR plus 3% through August 30, 1992; prime plus 2 1/4% through October 30, 1992; prime plus 2 1/2% through December 30, 1992 and prime plus 3% thereafter. A commitment fee of 0.5% of the daily average unutilized portion of the Reeves Revolving Loan is payable quarterly.

Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 1991, as filed with the Securities and Exchange Commission on March 30, 1992, for a more complete description of the Loan Agreement and the Indentures governing the debt securities.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### RESULTS OF OPERATIONS

The following table and the discussion which follows presents the Company's sales and operating income by segment for the quarters ended March 31, 1991 and March 29, 1992 (In thousands):

| | Quarter Ended | |
|---|---|---|
| | March 31, 1991 | March 29, 1992 |
| Net Sales: | | |
| Industrial Coated Fabrics Group | $ 28,999 | $ 29,149 |
| Apparel Textile Group | 32,627 | 37,226 |
| Total Net Sales | $ 61,626 | $ 66,375 |
| Operating Income: | | |
| Industrial Coated Fabrics Group | $ 5,295 | $ 5,554 |
| Apparel Textile Group | 1,373 | 2,895 |
| Corporate Expenses | (2,315) | (2,251) |
| Total Operating Income | $ 4,353 | $ 6,198 |
| Operating Income / Net Sales | 7.1% | 9.3% |

### THREE MONTHS ENDED MARCH 31, 1991 COMPARED WITH THREE MONTHS ENDED MARCH 29, 1992

### SALES

The Company's overall sales for the first three months of 1992 versus 1991 increased 7.7%. Sales of the Industrial Coated Fabrics Group represented 43.9% of the Company's total sales for the first three months of 1992 as compared with 47.1% for the comparable period in 1991. Sales of the Apparel Textile Group represented 56.1% of the Company's total sales for the first three months of 1992 as compared with 52.9% for the comparable period in 1991.

Sales of the Industrial Coated Fabrics Group were virtually the same as the first three months of 1991. The Group's Domestic sales increases in specialty coated fabrics and automotive airbag materials were offset by a decline in International sales. The increase in Domestic specialty coated fabrics was caused by an increase in unit volume and the increase in automotive airbag material sales was due to an increase in unit volume caused by the increasing inclusion of driver side airbags in U.S. manufactured cars. The decline in International sales was due to the continuing European recession.

The Apparel Textile Group's sales increased by 14.1% in the first three months of 1992 as compared to the first three months of 1991 primarily due to a shift to more fancy or higher priced goods.

## OPERATING INCOME

Operating income for the first three months of 1992 was $6.2 million as compared to operating income of $4.4 million for the first three months of 1991. As a percentage of sales, operating income increased to 9.3% for the first three months of 1992 compared to 7.1% in the same period of 1991.

Operating income of the Industrial Coated Fabrics Group for the first three months of 1992 increased 4.9% as compared to the first three months of 1991, primarily as a result of an increase in Domestic sales volume for specialty coated fabrics and automotive airbag material and improved manufacturing costs primarily resulting from prior capital investments.

The Apparel Textile Group's operating income for the first three months of 1992 increased 110.9% as compared to the first three months of 1991, primarily due to stronger margins on the higher priced goods and manufacturing cost reductions associated with prior capital investments.

## LIQUIDITY AND CAPITAL RESOURCES

The Loan Agreement provided Reeves Industries with a $44.9 million revolving line of credit facility and a $11.5 million letter of credit facility to provide liquidity. The balance outstanding under the revolving line of credit at December 31, 1991 was $30.0 million. Reeves Industries had outstanding letters of credit of $2.0 million at December 31, 1991.

In March 1992, Reeves Industries and the agent for the banks that are party to the Loan Agreement agreed to an amendment to the Loan Agreement. Concurrent with the consummation of the Amendment, Reeves

Industries paid, out of available funds, the $30.0 million revolving loan outstanding as of December 31, 1991 which was due March 31, 1992.

The Amendment to the Loan Agreement replaces the revolving line of credit facility and letters of credit facility with a $20.0 million revolving line of credit facility and a $5.0 million letters of credit facility to provide liquidity. Outstanding letters of credit reduce dollar for dollar the amount that may be borrowed as revolving loans. Management believes that funds available under these credit facilities will be sufficient to supplement funds generated from operations to meet the working capital and capital expenditure requirements of the Company through the termination of the facility which will occur on the earlier of the completion of a refinancing of certain of Reeves Industries' existing debt securities or January 29, 1993.

In April 1992, Reeves Industries filed a registration statement with the Securities and Exchange Commission with respect to a public offering of $121.5 million of Senior Notes due 2002 (the "New Senior Notes"). Proceeds of the offering will be used to redeem all of Reeves Industries' outstanding 12 1/2% Senior Notes, all of Reeves Industries' outstanding 13% Senior Subordinated Debentures and repay revolving loans that will be outstanding under the revolving loan facility. The completion of the offering will result in the termination of the Loan Agreement.

The Company intends to arrange for another revolving loan/letter of credit facility to replace the Loan Agreement and is engaged in discussion with banks for that purpose. Whether or not the Company obtains such a facility, the Company expects to be able to fund its working capital needs, capital expenditure requirements and debt service obligations from current cash balances and cash flow from operations.

In February 1992, Reeves Industries received approximately $17.0 million from the federal government in payment of a tax refund receivable which was recorded as of December 31, 1991. The refund resulted from Reeves Industries carrying back operating losses generated in 1991, primarily related to the disposal of the ARA Automotive Group, to offset previous year's taxable income.

## PART II. OTHER INFORMATION

### Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

| | Description | Page |
|---|---|---|
| Exhibit 11 | Computation of Earnings Per Common Share | 18 |

(b) Reports on Form 8-K

There were no reports on Form 8-K filed during the three months ended March 29, 1992.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HART HOLDING COMPANY INCORPORATED

DATE: May 12, 1992

By: ______________________
Steven W. Hart
Chief Financial Officer

EXHIBIT 11.

## CALCULATION OF PRIMARY AND FULLY DILUTED EARNINGS PER COMMON SHARE

HART HOLDING COMPANY INCORPORATED AND SUBSIDIARIES
(In thousands, except per share data)

| | Quarter Ended | |
|---|---|---|
| | March 31, 1991 | March 29, 1992 |
| Net income | $ 256 | $ 1,364 |
| Earnings Per Common Share: | | |
| Primary: | | |
| Net income | $ .02 | $ .09 |
| Fully diluted: | | |
| Net income | $ .02 | $ .09 |

EXHIBIT 11.
CALCULATION OF PRIMARY AND FULLY DILUTED EARNINGS PER COMMON SHARE
(Continued)
HART HOLDING COMPANY INCORPORATED AND SUBSIDIARIES
(In thousands, except per share data)

| | Quarter Ended | |
|---|---|---|
| | March 31, 1991 | March 29, 1992 |
| Weighted average number of common shares outstanding: | | |
| Primary | 15,201 | 15,157 |
| Fully diluted | 15,201 | 15,157 |

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**FORM 10-Q. - QUARTERLY REPORT UNDER SECTION 13 OR 15(d)**
**OF THE SECURITIES EXCHANGE ACT OF 1934**
***(As last amended in Rel. No. 34-26589, eff. 4/12/89.)***

PROCESSED BY
MAY 14 1992

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**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

1. C

**FORM 10-Q**
**(Mark One)**

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the period ended March 31, 1992

or

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ____________________ to ____________________

Commission file number 0-12668

HILLS BANCORPORATION
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| IOWA | 42-1208067 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 131 MAIN STREET, HILLS, IOWA | 52235 |
| (Address of principal executive offices) | (zip code) |

(319) 679-2291
(Registrant's telephone number, including area code)

NOT APPLICABLE
(Former name, former address, and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. [X] Yes [ ] No

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

| CLASS | SHARES OUTSTANDING at April 30, 1992 |
|---|---|
| Common Stock, no par value | 484,700 |

## HILLS BANCORPORATION
## Index to Form 10-Q

## Part I
## FINANCIAL INFORMATION

| | | Page Number |
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## Part II
## OTHER INFORMATION

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| COMPUTATION OF EARNINGS PER SHARE | | 10 |
| SIGNATURES | | 11 |

# HILLS BANCORPORATION
## CONSOLIDATED BALANCE SHEETS
(In Thousands)

| | March 31, 1992<br>Unaudited | December 31, 1991* |
|---|---|---|
| **ASSETS** | | |
| Cash and due from banks | $ 5,957 | $ 7,240 |
| Investment securities [market value March 31, 1992 $105,926; December 31, 1991 $105,391] | 104,296 | 102,857 |
| Federal funds sold | 14,850 | 20,150 |
| Loans | 225,541 | 218,091 |
| Less allowance for loan losses | 4,777 | 4,650 |
| | $ 220,764 | $ 213,441 |
| Property and equipment, net | 5,291 | 5,393 |
| Accrued interest receivable | 3,935 | 3,736 |
| Deferred income taxes, net | 760 | 760 |
| Other assets | 527 | 446 |
| | $ 356,380 | $ 354,023 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| **LIABILITIES** | | |
| Noninterest-bearing deposits | $ 24,323 | $ 26,266 |
| Interest-bearing deposits | 290,697 | 286,313 |
| Total deposits | $ 315,020 | $ 312,579 |
| Securities sold under agreements to repurchase | 4,798 | 5,463 |
| Accrued interest payable | 1,939 | 2,119 |
| Guarantee of Employee Stock Ownership Plan debt | 476 | 586 |
| Other liabilities | 1,294 | 704 |
| | $ 323,527 | $ 321,451 |
| **REDEEMABLE COMMON STOCK HELD BY EMPLOYEE STOCK OWNERSHIP PLAN (ESOP)** | $ 3,875 | $ 3,855 |
| **STOCKHOLDERS' EQUITY** | | |
| Capital stock, common, no par value; authorized 2,000,000 shares; issued 484,700 shares | $ 8,668 | $ 8,668 |
| Retained earnings | 24,661 | 24,490 |
| | $ 33,329 | $ 33,158 |
| Less: | | |
| Employee Stock Ownership Plan debt guarantee | 476 | 586 |
| Maximum cash obligation related to ESOP shares | 3,875 | 3,855 |
| | $ 28,978 | $ 28,717 |
| | $ 356,380 | $ 354,023 |

* Condensed from audited financial statements.

## HILLS BANCORPORATION
## UNAUDITED CONSOLIDATED STATEMENTS OF INCOME
Three Months Ended March 31, 1992 and 1991
(In Thousands)

| | 1992 | 1991 |
|---|---|---|
| **Interest Income:** | | |
| Interest and fees on loans | $ 5,588 | $ 5,428 |
| Interest on investment securities | 1,807 | 1,783 |
| Other interest income | 167 | 457 |
| Total interest income | $ 7,562 | $ 7,668 |
| **Interest Expense:** | | |
| Interest on deposits | $ 4,493 | $ 4,762 |
| Interest on securities sold under agreements to repurchase | 17 | 91 |
| Interest on capitalized lease | 2 | 2 |
| Interest portion of Employee Stock Ownership Plan contribution | 7 | 11 |
| Total interest expense | $ 4,519 | $ 4,866 |
| Net interest income | $ 3,043 | $ 2,802 |
| Provision for loan losses | 120 | 180 |
| Net interest income after provision for loan losses | $ 2,923 | $ 2,622 |
| **Other Income:** | | |
| Trust department fees | $ 87 | $ 53 |
| Deposit account charges and fees | 327 | 266 |
| Other fees and charges | 452 | 239 |
| | $ 866 | $ 558 |
| **Other Expenses:** | | |
| Salaries and employee benefits | $ 1,103 | $ 1,014 |
| Occupancy expenses | 131 | 120 |
| Furniture and equipment | 203 | 219 |
| F.D.I.C. insurance | 176 | 136 |
| Office supplies and postage | 127 | 129 |
| Other operating expenses | 471 | 386 |
| | $ 2,211 | $ 2,004 |
| Income before income taxes | $ 1,578 | $ 1,176 |
| Federal and state income taxes | 462 | 313 |
| Net income | $ 1,116 | $ 863 |

| Per common share: | | 1992 | 1991 |
|---|---|---|---|
| | Net income | $ 2.30 | $ 1.78 |
| | Dividend, January | 1.95 | 1.65 |
| | Weighted average shares of common outstanding stock | 484,700 | 484,700 |

# HILLS BANCORPORATION
## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
## Three Months Ended March 31, 1992 and 1991

| | 1992 | 1991 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net income | $ 1,116 | $ 863 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| *Depreciation* | 155 | 163 |
| Provision for possible loan losses | 120 | 180 |
| Increase in accrued interest receivable | < 199> | < 976> |
| Amortization of bond discount | 144 | 48 |
| Increase in other assets | < 81> | < 209> |
| Increase in accrued interest and other liabilities | 410 | 320 |
| Net cash provided by operating activities | $ 1,665 | $ 389 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Proceeds from maturities of investment securities | $ 7,064 | $ 6,492 |
| Purchase of investment securities | <8,647> | <14,933> |
| Federal funds sold, net | 5,300 | 5,225 |
| Loans made to customers, net of collections | <7,443> | < 3,628> |
| Purchases of property and equipment | < 53> | < 55> |
| Net cash (used in) investing activities | $ <3,779> | $< 6,899> |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Net increase in deposits | $ 2,441 | $ 3,566 |
| Net increase <decrease> in securities sold under agreements to repurchase | < 665> | 2,326 |
| Dividends paid | < 945> | < 799> |
| Net cash provided by financing activities | $ 831 | $ 5,093 |
| Increase (decrease) in cash and due from banks | $ <1,283> | $< 1,417> |
| **CASH AND DUE FROM BANKS** | | |
| Beginning | $ 7,240 | 8,744 |
| Ending | $ 5,957 | $ 7,327 |
| **SUPPLEMENTAL DISCLOSURES** | | |
| Cash payments for: | | |
| Interest paid to depositors | $ 4,314 | $ 4,742 |
| Interest paid on other obligations | 25 | 40 |
| Income taxes | 627 | 506 |
| Non-cash financing transactions: | | |
| Increase in stockholders' equity related to ESOP debt | 110 | 93 |
| Increase in maximum cash obligation related to ESOP shares | 20 | 8 |

See Note to Financial Statements.

## HILLS BANCORPORATION

## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

### Note 1. Interim Financial Statements

Interim consolidated financial statements have not been examined by independent public accountants, but include all adjustments (consisting only of normal recurring accruals) which in the opinion of management are necessary for a fair presentation of the results for these periods. The results of operation for the interim periods are not necessarily indicative of the results for a full year.

For purposes of reporting cash flows, cash and due from banks includes cash on hand and amount due from banks (including cash items in process of clearing). Cash flows from demand deposits, NOW accounts, savings accounts, and federal funds purchased and sold are reported net since their original maturities are less than three months. Cash flows from loans and time deposits are presented as net increases or decreases as permitted by FASB Statement No. 104.

# HILLS BANCORPORATION
# MANAGEMENT'S DISCUSSION AND ANALYSIS
# OF THE FINANCIAL CONDITION AND RESULTS OF OPERATION

The consolidated balance sheets of Hills Bancorporation as of March 31, 1992 reflects total assets of $356,380,000. This is an increase of $2,357,000 over the December 31, 1991 balances. Net loans were $220,764,000 and $213,441,000 for the periods ending March 31, 1992 and December 31, 1991, respectively. This increase of $7.3 million represents primarily single family residential loans located in the Iowa City and Coralville area. The real estate market continues to be very good in our trade area, especially the Iowa City and Coralville market areas. The result of this strong demand has been both an increase in demand for in-house real estate loans and secondary real estate market applications and a desire to reprice loans as interest rates fell to 20 year lows in January 1992. In addition to people moving up to higher priced homes because of the drop in interest rates, the Iowa City market continues to see new homes built and this is a reflection of the overall strength of the local economy. Most of the homes were funded primarily by use of federal funds that had previously been held for this expected loan demand. It is expected that deposits will grow in the second and third quarters and that this will take care of any demands for future loan growth.

On the liability side of the bank, deposits when securities sold under agreements to repurchase are included, ended the period of March 31, 1992 totaling $319,818,000 and this is an increase of just under $2 million for the first three months. Deposits including repos were $318,042,000 at December 31, 1991. The interest in short-term interest-bearing accounts is still evident as customers do not want to extend at this time because the interest rates available on longer term funds are not as attractive to them as in the past, so their tendency is to invest short rather than going out three to five years. The bank continues to monitor through their asset liability committee on a monthly basis the need for funds and the interest rate sensitivity position of the bank. Due to the fact that loans have a fixed maturity date and can be prepaid without penalties and that deposits can also be withdrawn even with penalties on certificates of deposits risk still exists even when it appears the bank is doing a perfect job of being matched. All interest-bearing checking, savings, and money market accounts are included as maturing immediately because of the repricing possibility, however, the bank's historical data would continue to indicate that these have been very stable deposits without much interest rate fluctuation. It is historically true that these accounts would not need to be adjusted upward as quickly in periods of rate increases so the interest rate exposure would be less than our repricing schedules would indicate.

In January of 1992, Hills Bancorporation paid a dividend of $1.95 per share to all shareholders on total outstanding stock of 484,700 shares. The total dividend of $945,165 is deducted from stockholders' equity and is reflected in the resulting stockholders' equity as of March 31, 1991 of $28,978,000. The dividend of $1.95 per share represents an 18.18% increase from the $1.65 paid in January, 1991.

The total stockholders' equity of Hills Bancorporation is $33,329,000 before the reduction for the Employee Stock Ownership Plan (ESOP) debt guarantee and the related cash obligations related to ESOP shares. As a percent of total assets this is 9.35%. Under risk-based capital rules, total capital is 10.13% of risk-adjusted assets, compared to the current 8% requirement.

The consolidated net income for the three months ended March 31, 1992 was $1,116,000 compared to $863,000 for the same period ended March 31, 1991. This is an increase of $253,000 representing an earnings per share for the first three months of 1992 being $2.30 compared to $1.78 for the same three months in 1991. Net interest income is up by $241,000 over the prior three months one year ago and is reflective primarily of volume increases in terms of total number of assets while the interest rate margin which is the difference between what the bank earns on investments and loans and pays on interest-bearing deposits has gone down slightly over this time period. Total average earning assets were up over $23 million for the first quarter of 1992 compared to the same period in 1991. The provision for loan losses is $60,000 less than for the three months ended March 31, 1991 and is reflective of management's overall opinion of the loan portfolio at this time and the level of the reserve as of March 31, 1992.

Other income of the bank was $866,000 compared to $558,000 for the periods ended March 31, 1992 and 1991, respectively. Secondary market loan origination fees included in other fees and charges amounted to $209,000 for the period ended March 31, 1992 and only $45,000 for the period ended March 31, 1991. Other increases were primarily in the area of account charges and fees which were the results of both some increase in fees and in number of accounts being administered.

In regards to other expenses, they have increased from $2,004,000 for the three months ended March 31, 1991 to $2,211,000 for the period ended March 31, 1992. Of this increase of $207,000, $40,000 is from increases in F.D.I.C. insurance and this is primarily a rate increase over the prior year. Salary and employee benefits have increased compared to one year ago by $89,000. This is a combination of salary increases and the number of full-time equivalent employees increasing from March 31, 1991 to March 31, 1992 by seven employees. Other operating expenses are up $85,000 from one year ago primarily due to costs associated with several new programs introduced including a more focused employee training program and a customer loyalty banking program started to reward customers who do their banking with Hills Bank.

Federal and state income taxes are up primarily due to more income before income taxes of $1,578,000 for March 31, 1992 compared to $1,176,000 for March 31, 1991. Earnings per share were $2.30 and $1.78 for the periods ended March 31, 1992 and March 31, 1991, respectively.

The Bank's principal sources of funds continues to be prepayment of loan principal and current amortized loan payments. In addition, funds are provided from current operations. All of the funds are used to fulfill loan commitments, make short-term investments, and fund any deposit withdrawals needed. The Company has no material commitments or plans which will affect its liquidity or capital resources. The acquisition of property and equipment may be in cash purchases, or they may be financed if favorable terms are available.

## HILLS BANCORPORATION

## PART II - OTHER INFORMATION

Item 1. Legal Proceedings

There are no material pending legal proceedings.

Item 2. Changes in Securities

There were no changes in securities.

Item 3. Defaults upon Senior Securities

Hills Bancorporation has no senior securities.

Item 4. Submission of Matters to a Vote of Security Holders

There have been no matters submitted to a vote of security holders during the quarter ended March 31, 1992.

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibit
See exhibit II - Statement Re Computation of Earnings Per Common Share

(b) Reports on Form 8-K
No reports on Form 8-K have been filed during the quarter ended March 31, 1992.

# HILLS BANCORPORATION

## EXHIBIT II

## COMPUTATION OF EARNINGS PER COMMON SHARE

| | Three Months Ended March 31 | |
|---|---|---|
| | 1992 | 1991 |
| Shares of common stock, beginning | 484,700 | 484,700 |
| Shares issued during this period | --- | --- |
| Shares of common stock, ending | 484,700 | 484,700 |
| Weighted average number of shares outstanding | 484,700 | 484,700 |
| Earnings and Earnings per share: | | |
| Net income (in tho[illegible]) | $ 1,116 | $ 862 |
| Earnings per common share | $ 2.30 | $ 1.78 |

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**HILLS BANCORPORATION**
(Registrant)

MAY 12 1992

Date

Dwight O. Seegmiller, President

(Duly authorized officer of the registrant)

James G. Pratt

James G. Pratt, Treasurer
(Principal Financial Officer)

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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended March 31, 1992

or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period ______________ to __

Commission file number 0-15658

BEST COPY
AVAILABLE

PETER KIEWIT SONS', INC.
(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

47-0210602
(I.R.S. Employer
Identification No.)

1000 Kiewit Plaza, Omaha, Nebraska
(Address of principal executive offices)

L30

68131
(Zip Code)

PROCESSED BY
33-32 = 1
MAY 18 1992

402-342-2052
(Registrant's telephone number,
including area code)

Microfilmed by
Q-Data Corp. - St. Petersburg, FL

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such report(s)), and (2) has been subject to such filing requirements for the past 90 days. Yes X No___

The number of shares outstanding of each class of the issuer's common stock, as of May 1, 1992:

| | |
|---|---|
| Class B Common Stock.............................. | 1,257,000 shares |
| Class C Common Stock.............................. | 14,761,246 shares |
| Class D Common Stock.............................. | 20,471,577 shares |

number of sequentially numbered pages: 35
Exhibit index located at page: 31

## PETER KIEWIT SONS', INC. AND SUBSIDIARIES

## Part I - Financial Information

Page

A. Consolidated

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- Consolidated Condensed Balance Sheets P-2
- Consolidated Condensed Statements of Cash Flows P-4
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B. Kiewit Construction & Mining Group

Item 1. Financial Statements
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- Condensed Balance Sheets C-2
- Condensed Statements of Cash Flows C-3
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C. Kiewit Diversified Group

Item 1. Financial Statements
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## Part II - Other Information

Item 1. Legal Proceedings 1

Item 2. Changes in Securities 1

Item 6. Exhibits and Reports on Form 8-K 2

## PETER KIEWIT SONS', INC. AND SUBSIDIARIES
## Consolidated Condensed Statements of Earnings
(unaudited)

| (dollars in millions, except per share data) | Three months ended March 31, 1992 | 1991 |
|---|---|---|
| Revenue | $ 442 | $ 446 |
| Other Income | 28 | 21 |
| | 470 | 467 |
| Costs and Expenses: | | |
| Cost of revenue | 387 | 401 |
| Selling and administrative | 45 | 42 |
| Interest | 3 | 20 |
| | 435 | 463 |
| Earnings from Continuing Operations Before Income Taxes | 35 | 4 |
| Provision for Income Taxes | 12 | 2 |
| Earnings from Continuing Operations | 23 | 2 |
| Discontinued Operations: | | |
| Earnings from discontinued operations net of income taxes of $ - and $12 | - | 5 |
| Net Earnings | $ 23 | $ 7 |
| Earnings Per Common and Common Equivalent Share: | | |
| B&C Stock: | | |
| Primary | $ .50 | $ .26 |
| Fully Diluted | $ .50 | $ .26 |
| D Stock: | | |
| Primary: | | |
| Continuing Operations | $ .67 | $(.17) |
| Discontinued Operations | - | .26 |
| Net Earnings | $ .67 | $ .09 |
| Fully Diluted: | | |
| Continuing Operations | $ .66 | $(.17) |
| Discontinued Operations | - | .26 |
| Net Earnings | $ .66 | $ .09 |
| Cash Dividends per Common Share: | | |
| B&C Stock | $ .40 | $ .30 |
| D Stock | $1.60 | $ .70 |

See accompanying notes to consolidated condensed financial statements.

## PETER KIEWIT SONS', INC. AND SUBSIDIARIES

## Consolidated Condensed Balance Sheets

| (dollars in millions) | March 31, 1992 | December 28, 1991 |
|---|---|---|
|  | (unaudited) |  |
| **Assets** |  |  |
| Current Assets: |  |  |
| Cash and cash equivalents | $ 66 | $ 243 |
| Temporary investments, at lower of cost or market | 875 | 825 |
| Receivables, less allowance of $7 and $7 | 223 | 266 |
| Notes receivable from sales of discontinued operations | 160 | 72 |
| Costs and earnings in excess of billings on uncompleted construction contracts | 106 | 71 |
| Investment in construction joint ventures | 51 | 45 |
| Deferred income taxes | 29 | 21 |
| Other | 50 | 79 |
| Total Current Assets | 1,560 | 1,622 |
| Property, Plant and Equipment, less accumulated depreciation and amortization of $544 and $546 | 354 | 348 |
| Notes Receivable from Sales of Discontinued Operations | 144 | 244 |
| Investments | 191 | 186 |
| Other Assets | 223 | 232 |
|  | $2,472 | $2,632 |

See accompanying notes to consolidated condensed financial statements.

## PETER KIEWIT SONS', INC. AND SUBSIDIARIES

### Consolidated Condensed Balance Sheets

| (dollars in millions, except per share data) | March 31, 1992 | December 28, 1991 |
|---|---|---|
| **Liabilities and Stockholders' Equity** | (unaudited) | |
| Current Liabilities: | | |
| Accounts payable | $ 187 | $ 198 |
| Current portion of long-term debt | 2 | 15 |
| Accrued construction costs and billings in excess of revenue on uncompleted contracts | 125 | 116 |
| Accrued insurance costs | 62 | 61 |
| Other | 135 | 159 |
| Total Current Liabilities | 511 | 549 |
| Long-Term Debt, less current portion | 90 | 110 |
| Deferred Income Taxes | 308 | 306 |
| Retirement Benefits | 58 | 58 |
| Accrued Reclamation Costs | 93 | 93 |
| Other Liabilities | 117 | 120 |
| Stockholders' Equity: | | |
| Preferred stock, no par value, Authorized 250,000 shares: no shares outstanding | | |
| Common stock, $.0625 par value, $1.2 billion aggregate redemption value: | | |
| Class B, authorized 8,000,000 shares: 1,257,000 outstanding in 1992 and 1,394,000 in 1991 | - | - |
| Class C, authorized 125,000,000 shares: 14,828,033 outstanding in 1992 and 19,384,278 in 1991 | 1 | - |
| Class D, authorized 50,000,000 shares: 20,493,295 outstanding in 1992 and 20,778,278 in 1991 | 1 | 1 |
| Additional paid-in capital | 121 | 129 |
| Foreign currency adjustment | 5 | 9 |
| Retained earnings | 1,167 | 1,257 |
| Total Stockholders' Equity | 1,295 | 1,396 |
| | $2,472 | $2,632 |

See accompanying notes to consolidated condensed financial statements.

## PETER KIEWIT SONS', INC. AND SUBSIDIARIES

### Consolidated Condensed Statements of Cash Flows
(unaudited)

| | Three months ended March 31. | |
|---|---|---|
| (dollars in millions) | 1992 | 1991 |
| Cash flows from operations: | | |
| Net cash provided by continuing operations | $ 5 | $ 33 |
| Cash flows from investing activities: | | |
| Proceeds from sales of temporary investments | 1,749 | 712 |
| Purchases of temporary investments | (1,805) | (443) |
| Proceeds from sales of property, plant and equipment, and other investments | 12 | 5 |
| Capital expenditures | (27) | (33) |
| Investment in affiliate | (5) | (29) |
| Other | (2) | (4) |
| Net cash provided by (used in) investing activities | (78) | 208 |
| Cash flows from financing activities: | | |
| Long-term debt borrowings | - | 19 |
| Payments on long-term debt, including current portion | (33) | (70) |
| Net change in short-term borrowings | - | (100) |
| Repurchases of common stock | (80) | (136) |
| Dividends paid | (10) | (11) |
| Net cash used in financing activities | (123) | (298) |
| Cash flows from discontinued packaging operations: | | |
| Proceeds from sales of discontinued packaging operations | 16 | 286 |
| USW ERISA Litigation settlement installment payment | - | (207) |
| Other cash provided by discontinued packaging operations | 3 | 24 |
| Net cash provided by discontinued packaging operations | 19 | 103 |
| Effect of exchange rates on cash | - | 1 |
| Net change in cash and cash equivalents | (177) | 47 |
| Cash and cash equivalents at beginning of period | 243 | 256 |
| Cash and cash equivalents at end of period | $ 66 | $ 303 |
| Supplemental disclosure of cash flow information for continuing and discontinued operations: | | |
| Taxes | $ 19 | $ 22 |
| Interest | 4 | 21 |

See accompanying notes to consolidated condensed financial statements.

# PETER KIEWIT SONS', INC. AND SUBSIDIARIES

## Notes to Consolidated Condensed Financial Statements

1. The consolidated condensed balance sheet of Peter Kiewit Sons', Inc. and subsidiaries (the "Company") at December 28, 1991 has been condensed from the Company's audited balance sheet as of that date. For comparative purposes, the December 28, 1991 balance sheet presents the new Class B&C and Class D stock amounts as if the reclassification and exchange occurred at the beginning of 1991. All other financial statements contained herein are unaudited and, in the opinion of management, contain all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of financial position and results of operations for the periods presented. The Company's accounting policies and certain other disclosures are set forth in the notes to the consolidated financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 28, 1991.

   The consolidated condensed statement of earnings for the three months ended March 31, 1991 was restated when the Company filed, on April 29, 1992, a Form 8, Amendment 1, to its March 31, 1991 Quarterly Report on Form 10-Q. The Form 8 restated the Company's results of operations and financial position to reflect the adoption of Statement of Financial Accounting Standards ("SFAS") No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions", as of the beginning of 1991.

   Where appropriate, items within the consolidated condensed financial statements have been reclassified from the previous year to conform to current year presentation.

2. Subsequent to March 31, 1992, the Company collected $100 million in cash when Plastic Containers, Inc. repaid a bridge note receivable prior to maturity. Accordingly, the note was reclassified to current at March 31, 1992.

   Discontinued packaging operations for the quarter ended March 31, 1992 is less than $1 million and reflects the equity earnings of the Company's equity investment in a plastics joint venture, net of tax at the statutory rate. Summary financial information relative to the discontinued packaging operations for the quarter ended March 31, 1991 is provided below:

| (dollars in millions) | 1991 |
|---|---|
| Revenue | $604 |
| Earnings Before Income Taxes | 17 |
| Net Earnings | 5 |

The effective 1991 income tax rate was higher than the statutory rate of 34%, primarily resulting from the effects of purchase accounting, state income taxes and higher taxes on foreign earnings.

## PETER KIEWIT SONS', INC. AND SUBSIDIARIES

### Notes to Consolidated Condensed Financial Statements

3. Primary earnings per share of common stock have been computed using the weighted average number of shares outstanding during each period. For purposes of computing earnings per share data for periods prior to January 8, 1992, the number of Class B&C and Class D shares was assumed to be the same as the aggregate number of previous Class B and Class C shares. Fully diluted earnings per share assume the conversion of convertible debentures and elimination of related interest expense, net of income tax effect. The number of shares used in computing earnings per share was as follows:

| | Three months ended March 31 | |
|---|---|---|
| | 1992 | 1991 |
| Class B&C | | |
| Primary | 19,338,325 | 20,617,776 |
| Fully diluted | 19,444,623 | 20,718,481 |
| Class D | | |
| Primary | 19,870,894 | 20,617,776 |
| Fully diluted | 19,977 192 | 20,718,481 |

4. See "Legal Proceedings" with respect to the Whitney Benefits case in Part II, Item 1 of this Form 10-Q.

   The Company is involved in various lawsuits, claims and regulatory proceedings incidental to its business. Management believes that any resulting liability for legal proceedings beyond that provided should not materially affect the Company's financial position.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Results of Operations - First Quarter 1992 vs. First Quarter 1991

Revenue from continuing operations for the three months ended March 31 comprised the following (in millions):

| | 1992 | 1991 |
|---|---|---|
| Construction | $357 | $389 |
| Mining | 63 | 52 |
| Telecommunications | 22 | 4 |
| Other | - | 1 |
| | $442 | $446 |

### General

Although certain construction activities such as highway and bridge work are negatively impacted by cold or adverse weather, the construction and mining operations in general are not considered seasonal in nature. Working capital is generally negatively impacted in the early phases of a construction contract, as the Company is frequently required to pay for construction materials and labor prior to receiving cash from its customers.

### Construction

Construction revenue decreased 8% as the result of lower activity throughout the country and in Canada and the completion of various large projects which were reflected during the first quarter of 1991. Contract backlog at the end of the first quarter of 1992 was $1.9 billion, a $100 million decrease from backlog at first quarter 1991. Of the 1992 backlog, 12% relates to foreign projects which are mainly in Canada. The remaining first quarter backlog relates to U.S. projects, 46% of which are on the west coast. The gross margin was 7% in both 1992 and 1991.

The joint venture management of the nonsponsored Denmark tunnel project has completed negotiations with respect to the settlement of current claims against the project owner. The new agreement also covers additional costs and time extensions due to differing conditions at the site of the tunnel mining. Claims against an equipment supplier are currently being negotiated. Insurance claims with respect to the flooding of two of the four tunnels being mined as part of the project are still in the process of settlement. Management believes that these developments and the resolution of the uncertainties should not materially effect the Company's financial position.

## Results of Operations - First Quarter 1992 vs. First Quarter 1991 (continued)

### Mining

Mining revenue increased by 21% compared to the first quarter of 1991. Among the factors contributing to the increase was a 20% increase in tons of coal and lignite shipped and a 1% increase in the average sales price per ton. Revenue recognition on previously consummated sales of undivided interests in coal reserves to be mined in the future remained constant at $10 million.

The Calvert mine showed the greatest percentage increase in tons shipped while the shipments from the Decker and Black Butte mines reflected a modest increase over first quarter 1991 results. The Calvert mine has reached delivery levels of coal for its primary customer as required by contract. Continued significant increases in shipments from this mine are not anticipated in the near future. The increased shipments from the Decker and Black Butte mines reflect sales from new contracts and sales on the spot market. The average sales price per ton modestly increased due to the shipments from the Black Butte mine which have a higher contractual sales price per ton than the other mines.

The gross margin on mining revenue approximated 30% during the first quarter of 1992 compared to 23% during the same period in 1991. The increase in gross margin is the result of an upward adjustment to the sales price per ton on an existing contract and the negotiation of new contracts and spot market sales. The new contracts and spot market sales have enabled the various mines to increase productivity, thereby reducing the mining costs per ton and increasing the margin realized per ton.

See "Legal Proceedings" with respect to the Whitney Benefits case.

### Telecommunications

Telecommunications revenue increased significantly during 1992. The increase results from MFS' acquisition during the fourth quarter of 1991 of a majority interest in a telecommunications business which provides service to the greater Washington D.C. area and improved market penetration in the other cities where MFS operates. The 1992 revenue also increased as a result of KNT, which was included in the construction segment in 1991, being awarded several system integration contracts to design and install communication systems for its customers. Cost of services in excess of revenue in 1992 decreased as a result of improved operating efficiencies which have favorably impacted the fixed and variable costs associated with providing these services.

## Results of Operations - First Quarter 1992 vs. First Quarter 1991 (continued)

### Other Income

During the first quarter of 1992 and 1991, the Company recognized $18 million of investment income. A gain of $2 million from the sale of approximately 6,000 acres of timberland was recognized in the first three months of 1992. During the same period in 1991, a gain of $1 million related to the sale of approximately 3,000 acres of timberlands was recognized. Gains and losses from other miscellaneous asset dispositions made up the remainder of Other Income.

### Selling and Administrative Expenses

Selling and administrative expenses are higher in the first quarter of 1992 as compared to first quarter of 1991 due to a modest increase in several of the Company's administrative expenses and increases within the telecommunications operations.

### Interest Expense

Interest expense for the first quarter of 1992 reflects the anticipated decrease due to the significant reductions during 1991 in both short-term borrowings and long-term debt. All short-term borrowings were repaid in July of 1991 and no new borrowings have been incurred. The Company also redeemed $150 million of debt in October of 1991 with no new material debt incurred since year-end 1991. The Company does not anticipate significant additions of short-term borrowings or long-term debt in the near future.

### Discontinued Packaging Businesses

The remaining earnings from discontinued operations in 1992 result from the Company's equity investment in a plastics joint venture. Equity earnings from this investment were less than $1 million during the first quarter of 1992. Discontinued operations for the same period in 1991 primarily reflect earnings from packaging businesses which were sold subsequent to March 31, 1991. The adoption of Statement of Financial Accounting Standards ("SFAS") No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions", partially offsets 1991 first quarter earnings.

## Financial Condition - March 31, 1992 vs. December 28, 1991

During the first three months of 1992, the Company repurchased Class B&C and Class D shares, (assuming the reclassification and exchange occurred at the beginning of 1991, these shares would represent 1.3 million Class B&C shares and 1.3 million Class D shares), of common stock for $80 million, paid dividends of $10 million and on March 27, 1992, declared dividends of $.15 and $1.35 per share on Class B&C and Class D Stock, respectively, aggregating $30 million. The Company also retired $16 million of debt due to former stockholders, received $30 million from United States Can Company and collected $12 million with respect to receivables from the 1991 sales of certain discontinued packaging operations. Additionally, the Company invested $5 million for 447,500 shares of California Energy Company, Inc. common stock, bringing the Company's total investment to $99 million and ownership interest to approximately 19% at March 31, 1992. The Company has certain options to purchase additional shares of California Energy Company, Inc. common stock which it may choose to exercise in the future.

The Company's working capital position at the end of the first quarter of 1992, together with anticipated cash flows from operations, collection of receivables from the sales of various packaging operations and existing borrowing capacity, should be sufficient for the remainder of 1992's working capital and capital expenditure requirements. Subsequent to March 31, 1992, the Company purchased an additional 474,300 shares of California Energy Company, Inc. common stock for $6 million and collected $100 million in cash with respect to sales receivables when Plastic Containers, Inc. repaid a bridge note receivable prior to maturity. The Company anticipates that it will continue to invest between $65 million and $85 million annually in its construction and mining businesses, make significant investments in its telecommunication and energy businesses and search for opportunities to acquire operating businesses that are capital intensive and provide for long-term growth. The Company has been investigating and will continue to investigate these opportunities and intends to make significant acquisitions. These investments, along with the payment of income taxes and the repurchases of common stock, are expected to be the significant uses of liquidity. The Company's existing cash and cash equivalents, temporary investments, collection of sales receivables, cash flow from future operations and existing borrowing capacity are expected to provide sufficient liquidity to fund these expenditures.

The Company is currently required to adopt SFAS No. 109, "Accounting for Income Taxes", no later than 1993. The new standard would significantly change the method of accounting for income taxes. SFAS No. 109 permits, but does not require, restatement of previously issued financial statements. The Company has not yet elected the method, nor quantified the effect, of implementation on the financial statements.

## KIEWIT CONSTRUCTION & MINING GROUP
### Condensed Statements of Earnings
(unaudited)

| (dollars in millions, except per share data) | Three months ended March 31, 1992 | Three months ended March 31, 1991 |
|---|---|---|
| Revenue | $ 359 | $ 390 |
| Other Income | 22 | 11 |
| | 381 | 401 |
| Costs and Expenses: | | |
| Cost of revenue | 335 | 364 |
| Selling and administrative | 30 | 27 |
| Interest | - | 1 |
| | 365 | 392 |
| Earnings Before Income Taxes | 16 | 9 |
| Provision for Income Taxes | 6 | 4 |
| Net Earnings | $ 10 | $ 5 |
| Earnings Per Common and Common Equivalent Share: | | |
| Primary | $ .50 | $ .26 |
| Fully Diluted | $ .50 | $ .26 |
| Cash Dividends per Common Share | $ .40 | $ .30 |

See accompanying notes to condensed financial statements.

## KIEWIT CONSTRUCTION & MINING GROUP

### Condensed Balance Sheets

| (dollars in millions) | March 31, 1992 | December 28, 1991 |
|---|---|---|
| | (unaudited) | |
| **Assets** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 51 | $ 118 |
| Temporary investments, at lower of cost or market | 151 | 196 |
| Receivables, less allowance of $2 and $2 | 165 | 211 |
| Costs and earnings in excess of billings on uncompleted construction contracts | 106 | 71 |
| Investment in construction joint ventures | 51 | 45 |
| Other | 48 | 38 |
| Total Current Assets | 572 | 679 |
| | | |
| Property, Plant and Equipment, less accumulated depreciation and amortization of $355 and $358 | 119 | 120 |
| Other Assets | 40 | 50 |
| | $ 731 | $ 849 |
| **Liabilities and Stockholders' Equity** | | |
| Current Liabilities: | | |
| Accounts payable, including retainage of $33 and $38 | $ 126 | $ 162 |
| Current portion of long-term debt | 1 | 7 |
| Accrued construction costs and billings in excess of revenue on uncompleted contracts | 125 | 116 |
| Accrued insurance costs | 62 | 61 |
| Other | 31 | 48 |
| Total Current Liabilities | 345 | 394 |
| | | |
| Long-Term Debt, less current portion | 11 | 13 |
| Deferred Income Taxes | 5 | 3 |
| Other Liabilities | 36 | 39 |
| | | |
| Stockholders' Equity (Redeemable Common Stock, $225 million aggregate redemption value) | | |
| Common equity | 334 | 398 |
| Foreign currency adjustment | - | 2 |
| Total Stockholders' Equity | 334 | 400 |
| | $ 731 | $ 849 |

See accompanying notes to condensed financial statements.

## KIEWIT CONSTRUCTION & MINING GROUP

### Condensed Statements of Cash Flows
(unaudited)

| | Three months ended March 31, | |
|---|---|---|
| (dollars in millions) | 1992 | 1991 |
| **Cash flows from operations:** | | |
| Net cash provided by (used in) operations | $ (25) | $ 30 |
| **Cash flows from investing activities:** | | |
| Proceeds from sales of temporary investments | 273 | 308 |
| Purchases of temporary investments | (228) | (309) |
| Proceeds from sales of property, plant and equipment | 8 | 3 |
| Capital expenditures | (14) | (25) |
| Other | (2) | (1) |
| Net cash provided by (used in) investing activities | 37 | (24) |
| **Cash flows from financing activities:** | | |
| Long-term debt borrowings | - | 9 |
| Payments on long-term debt, including current portion | (8) | (14) |
| Repurchases of common stock | (18) | (41) |
| Dividends paid | (5) | (3) |
| Exchange of Class B&C Stock for Class D Stock | (48) | - |
| Net cash used in financing activities | (79) | (49) |
| Effect of exchange rates on cash | - | 1 |
| Net change in cash and cash equivalents | (67) | (42) |
| Cash and cash equivalents at beginning of period | 118 | 99 |
| Cash and cash equivalents at end of period | $ 51 | $ 57 |
| **Supplemental disclosure of cash flow information:** | | |
| Taxes | $ 9 | $ 2 |
| Interest | 2 | 2 |

See accompanying notes to condensed financial statements.

## KIEWIT CONSTRUCTION & MINING GROUP

### Notes to Condensed Financial Statements

1. The condensed balance sheet of Kiewit Construction & Mining Group (the "Group") at December 28, 1991 has been condensed from the Group's audited balance sheet as of that date. All other financial statements contained herein are unaudited and have been prepared using the historical amounts included in the PKS consolidated condensed financial statements. The Group's accounting policies and certain other disclosures are set forth in the notes to the financial statements contained in PKS' Annual Report on Form 10-K for the year ended December 28, 1991.

   Although the financial statements of PKS' Construction & Mining Group and Diversified Group separately report the assets, liabilities and stockholders' equity of PKS attributed to each such group, legal title to such assets and responsibility for such liabilities will not be affected by such attribution. Holders of Class B&C Stock and Class D Stock are stockholders of PKS. Accordingly, the PKS consolidated condensed financial statements and related notes as well as those of the Kiewit Diversified Group should be read in conjunction with these financial statements.

   Temporary investments at March 31, 1992 and December 28, 1991 include approximately $40 million and $42 million, respectively, of investments which are being held by the owners of various construction projects in lieu of retainage. Receivables at March 31, 1992 and December 28, 1991 include approximately $46 million and $47 million, respectively, of retainage on uncompleted projects, the majority of which is expected to be collected within one year.

2. Primary earnings per share of common stock have been computed using the weighted average number of shares outstanding during each period. Fully diluted earnings per share assume the conversion of convertible debentures and elimination of related interest expense, net of income tax effect. The number of shares used in computing earnings per share was as follows:

| | Three months ended March 31 | |
|---|---|---|
| | 1992 | 1991 |
| Class B&C | | |
| Primary | 19,338,325 | 20,617,776 |
| Fully diluted | 19,444,623 | 20,718,481 |

# KIEWIT CONSTRUCTION & MINING GROUP

## Notes to Condensed Financial Statements

3. The Group's 50% portion of PKS' corporate assets and liabilities and related transactions, which are not separately identified with the ongoing operations of the Construction & Mining Group or the Diversified Group, is as follows (in millions):

| | Group | |
|---|---|---|
| | March 31, 1992 | December 28, 1991 |
| Cash and cash equivalents | $ 5 | $ 15 |
| Temporary investments | 50 | 38 |
| Property, plant and equipment, net | 8 | 8 |
| Other assets | 33 | 36 |
| Total Assets | $ 96 | $ 97 |
| Accounts payable | $ 35 | $ 24 |
| Convertible debentures | 2 | 2 |
| Notes to former stockholders | 8 | 17 |
| Liability for stock appreciation rights | 2 | 4 |
| Other liabilities | 7 | 6 |
| Total Liabilities | $ 54 | $ 53 |

| | Group | |
|---|---|---|
| | Three months ended March 31, | |
| | 1992 | 1991 |
| Investment income, net of interest expense | $ 2 | $ 2 |
| Depreciation and stock appreciation rights costs | - | 1 |
| Other costs, net | 1 | 1 |

3. (continued)

   Corporate general and administrative costs have been allocated to the Group based upon certain measures of business activities, such as employment, investments and sales, which method management believes to be reasonable. These allocations were $8 million and $4 million for the three months ended March 31, 1992 and 1991, respectively.

   Mining service income that the Group recognized as a result of the Group's mine service agreement with the Diversified Group is $9 million in 1992 and $2 million in 1991.

4. The Group is involved in various lawsuits, claims and regulatory proceedings incidental to its business. Management believes that any resulting liability for legal proceedings beyond that provided should not materially affect the Group's financial position.

KIEWIT CONSTRUCTION & MINING GROUP

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Results of Operations - First Quarter 1992 vs. First Quarter 1991

### Construction

Construction revenue decreased 8% as the result of lower activity throughout the country and in Canada and the completion of various large projects which were reflected during the first quarter of 1991. Contract backlog at the end of the first quarter of 1992 was $1.9 billion, a $100 million decrease from backlog at first quarter 1991. Of the 1992 backlog, 12% relates to foreign projects which are mainly in Canada. The remaining first quarter backlog relates to U.S. projects, 46% of which are on the west coast. The gross margin was 7% in both 1992 and 1991.

The joint venture management of the nonsponsored Denmark tunnel project has completed negotiations with respect to the settlement of current claims against the project owner. The new agreement also covers additional costs and time extensions due to differing conditions at the site of the tunnel mining. Claims against an equipment supplier are currently being negotiated. Insurance claims with respect to the flooding of two of the four tunnels being mined as part of the project are still in the process of settlement. Management believes that these developments and the resolution of the uncertainties should not materially effect the Group's financial position.

### Other Income

During the first quarter of 1992 and 1991, the Group recognized $4 million and $5 million of investment income, respectively. Mining service income that the Group recognized as a result of the Group's mine service agreements with the Diversified Group was $9 million in 1992 and $2 million in 1991. Gains and losses from other miscellaneous asset dispositions made up the remainder of Other Income.

### Selling and Administrative Expenses

Selling and administrative expenses are higher in the first quarter of 1992 as compared to the first quarter of 1991 due to an increase in the allocation of corporate expenses to the Group.

### Interest Expense

Interest expense remained fairly constant and reflects the interest costs associated primarily with the convertible debentures and notes to former stockholders attributed to the Group.

# KIEWIT CONSTRUCTION & MINING GROUP

## Financial Condition - March 31, 1992 vs. December 28, 1991

During the first three months of 1992, the Group repurchased 1.3 million shares of common stock for $18 million, paid dividends of $5 million and declared an additional $2 million of dividends ($.15 per share), and retired $8 million of debt due to former stockholders. Additionally, the Group's common equity was reduced by $48 million upon the conversion of 3 million shares of Class B&C stock into 1 million shares of Class D stock. The Group's working capital position at the end of first quarter of 1992, along with anticipated cash flows from operations, should be sufficient for 1992 working capital and capital expenditure requirements. The Group anticipates that it will continue to invest between $50 million and $75 million annually in its construction business. These investments, along with the repurchases of common stock, are expected to be the significant long-term uses of liquidity. The Group's existing cash and cash equivalents, temporary investments and cash flow from future operations are expected to provide sufficient liquidity to fund these expenditures.

The Group is currently required to adopt Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes", no later than 1993. The new standard would significantly change the method of accounting for income taxes. SFAS No. 109 permits, but does not require, restatement of previously issued financial statements. The Group has not yet elected the method, nor quantified the effect, of implementation on the financial statements.

## KIEWIT DIVERSIFIED GROUP
## Condensed Statements of Earnings
(unaudited)

| (dollars in millions, except per share data) | Three months ended March 31, 1992 | 1991 |
|---|---|---|
| Revenue | $ 83 | $ 56 |
| Other Income | 15 | 12 |
| | 98 | 68 |
| Costs and Expenses: | | |
| Cost of revenue | 54 | 38 |
| Selling and administrative | 22 | 16 |
| Interest | 3 | 19 |
| | 79 | 73 |
| Earnings (loss) from Continuing Operations Before Income Taxes (Benefit) | 19 | (5) |
| Provision for Income Taxes (Benefit) | 6 | (2) |
| Earnings (loss) from Continuing Operations | 13 | (3) |
| Discontinued Operations: | | |
| Earnings from discontinued operations net of income taxes of $- and $12 | - | 5 |
| Net Earnings | $ 13 | $ 2 |
| Earnings Per Common and Common Equivalent Share: | | |
| Primary: | | |
| Continuing Operations | $ .67 | $(.17) |
| Discontinued Operations | - | .26 |
| Net Earnings | $ .67 | $ .09 |
| Fully Diluted: | | |
| Continuing Operations | $ .66 | $(.17) |
| Discontinued Operations | - | .26 |
| Net Earnings | $ .66 | $ .09 |
| Cash Dividends per Common Share: | $1.60 | $ .70 |

See accompanying notes to condensed financial statements.

KIEWIT DIVERSIFIED GROUP

Condensed Balance Sheets

| (dollars in millions) | March 31, 1992 | December 28, 1991 |
|---|---|---|
|  | (unaudited) |  |
| **Assets** |  |  |
| Current Assets: |  |  |
| Cash and cash equivalents | $ 15 | $ 125 |
| Temporary investments, at lower of cost or market | 724 | 629 |
| Receivables, less allowance of $5 and $5 | 67 | 64 |
| Notes receivable from sales of discontinued operations | 160 | 72 |
| Other | 40 | 71 |
| Total Current Assets | 1,006 | 961 |
| Property, Plant and Equipment, less accumulated depreciation and amortization of $189 and $188 | 235 | 228 |
| Notes Receivable from Sales of Discontinued Operations | 144 | 244 |
| Investments | 191 | 186 |
| Other Assets | 183 | 182 |
|  | $1,759 | $1,801 |
| Liabilities and Stockholders' Equity |  |  |
| Current Liabilities: |  |  |
| Accounts payable | $ 70 | $ 37 |
| Current portion of long-term debt | 1 | 8 |
| Other | 113 | 128 |
| Total Current Liabilities | 184 | 173 |
| Long-Term Debt, less current portion | 79 | 97 |
| Deferred Income Taxes | 303 | 303 |
| Retirement Benefits | 58 | 58 |
| Accrued Reclamation Costs | 93 | 93 |
| Other Liabilities | 81 | 81 |
| Stockholders' Equity ($948 million aggregate redemption value) |  |  |
| Common equity | 956 | 989 |
| Foreign currency adjustment | 5 | 7 |
| Total Stockholders' Equity | 961 | 996 |
|  | $1,759 | $1,801 |

See accompanying notes to condensed financial statements.

## KIEWIT DIVERSIFIED GROUP

### Condensed Statements of Cash Flows
(unaudited)

| | Three months ended March 31, | |
|---|---|---|
| (dollars in millions) | 1992 | 1991 |
| Cash flows from operations: | | |
| Net cash provided by continuing operations | $ 30 | $ 3 |
| Cash flows from investing activities: | | |
| Proceeds from sales of temporary investments | 1,476 | 404 |
| Purchases of temporary investments | (1,577) | (134) |
| Proceeds from sales of property, plant and equipment, and other investments | 4 | 2 |
| Capital expenditures | (13) | (8) |
| Investment in affiliate | (5) | (29) |
| Other | - | (3) |
| Net cash provided by (used in) investing activities | (115) | 232 |
| Cash flows from financing activities: | | |
| Long-term debt borrowings | - | 10 |
| Payments on long-term debt, including current portion | (25) | (56) |
| Net change in short-term borrowings | - | (100) |
| Repurchases of common stock | (62) | (95) |
| Dividends paid | (5) | (8) |
| Exchange of Class B&C Stock for Class D Stock | 48 | - |
| Net cash used in financing activities | (44) | (249) |
| Cash flows from discontinued packaging operations: | | |
| Proceeds from sales of discontinued packaging operations | 16 | 286 |
| USW ERISA Litigation settlement installment payment | - | (207) |
| Other cash provided by discontinued packaging operations | 3 | 24 |
| Net cash provided by discontinued packaging operations | 19 | 103 |
| Net change in cash and cash equivalents | (110) | 89 |
| Cash and cash equivalents at beginning of period | 125 | 157 |
| Cash and cash equivalents at end of period | $ 15 | $ 246 |
| Supplemental disclosure of cash flow information for continuing and discontinued operations: | | |
| Taxes | $ 10 | $ 20 |
| Interest | 2 | 19 |

See accompanying notes to condensed financial statements.

## KIEWIT DIVERSIFIED GROUP

### Notes to Condensed Financial Statements

1. The condensed balance sheet of Kiewit Diversified Group (the "Group") at December 28, 1991 has been condensed from the Group's audited balance sheet as of that date. All other financial statements contained herein are unaudited and have been prepared using historical amounts included in the PKS consolidated condensed financial statements. The Group's accounting policies and certain other disclosures are set forth in the notes to the financial statements contained in PKS' Annual Report on Form 10-K for the year ended December 28, 1991.

   Although the financial statements of PKS' Construction & Mining Group and Diversified Group separately report the assets, liabilities and stockholders' equity of PKS attributed to each such group, legal title to such assets and responsibility for such liabilities will not be affected by such attribution. Holders of Class B&C Stock and Class D Stock are stockholders of PKS. Accordingly, the PKS consolidated condensed financial statements and related notes as well as those of the Kiewit Construction & Mining Group should be read in conjunction with these financial statements.

2. Subsequent to March 31, 1992, the Group collected $100 million in cash when Plastic Containers, Inc. repaid a bridge note receivable prior to maturity. Accordingly, the note was reclassified to current at March 31, 1992.

   Discontinued packaging operations for the quarter ended March 31, 1992 is less than $1 million and reflects the equity earnings of the Group's equity investment in a plastics joint venture, net of tax at the statutory rate. Summary financial information relative to the discontinued packaging operations for the quarter ended March 31, 1991 is provided below:

| (dollars in millions) | 1991 |
|---|---|
| Revenue | $604 |
| Earnings Before Income Taxes | 17 |
| Net Earnings | 5 |

   The effective 1991 income tax rate was higher than the statutory rate of 34%, primarily resulting from the effects of purchase accounting, state income taxes and higher taxes on foreign earnings.

## KIEWIT DIVERSIFIED GROUP

### Notes to Condensed Financial Statements

3. Primary earnings per share of common stock have been computed using the weighted average number of shares outstanding during each period. For purposes of computing earnings per share data for the periods prior to January 8, 1992, the number of Class D shares was assumed to be the same as the aggregate number of previous Class B and Class C shares. Fully diluted earnings per share assume the conversion of convertible debentures and elimination of related interest expense, net of income tax effect. The number of shares used in computing earnings per share was as follows:

| | Three months ended March 31 | |
|---|---|---|
| | 1992 | 1991 |
| Class D | | |
| Primary | 19,870,894 | 20,617,776 |
| Fully diluted | 19,977,192 | 20,718,481 |

4. The Group's 50% portion of PKS' corporate assets and liabilities and related transactions, which are not separately identified with the ongoing operations of the Construction & Mining Group or the Diversified Group, is as follows (in millions):

| | Group | |
|---|---|---|
| | March 31, 1992 | December 28, 1991 |
| Cash and cash equivalents | $ 5 | $ 16 |
| Temporary investments | 51 | 37 |
| Property, plant and equipment, net | 8 | 8 |
| Other assets | 33 | 37 |
| Total Assets | $ 97 | $ 98 |
| Accounts payable | $ 35 | $ 24 |
| Convertible debentures | 2 | 2 |
| Notes to former stockholders | 9 | 17 |
| Liability for stock appreciation rights | 2 | 4 |
| Other liabilities | 7 | 7 |
| Total Liabilities | $ 55 | $ 54 |

4. (continued)

| | Group<br>Three months ended<br>March 31,<br>1992 | <br><br><br>1991 |
|---|---|---|
| Investment income, net of interest expense | $ 2 | $ 1 |
| Depreciation and stock appreciation rights costs | - | 1 |
| Other costs, net | 1 | 1 |

Corporate general and administrative costs have been allocated to the Group based upon certain measures of business activities, such as employment, investments and sales, which method management believes to be reasonable. These allocations were $3 million and $4 million for the three months ended March 31, 1992 and 1991, respectively.

Mining service expense that the Group recognized as a result of the Group's mine service agreement with the Construction & Mining Group is $9 million in 1992 and $2 million in 1991.

5. See "Legal Proceedings" with respect to the Whitney Benefits Case in Part II, Item 1 of this Form 10-Q.

The Group is involved in various lawsuits, claims and regulatory proceedings incidental to its business. Management believes that any resulting liability for legal proceedings beyond that provided should not materially affect the Group's financial position.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Results of Operations - First Quarter 1992 vs. First Quarter 1991

### Mining

Mining revenue increased by 21% compared to the first quarter of 1991. Among the factors contributing to the increase was a 20% increase in tons of coal and lignite shipped and a 1% increase in the average sales price per ton. Revenue recognition on previously consummated sales of undivided interests in coal reserves to be mined in the future remained constant at $10 million.

The Calvert mine showed the greatest percentage increase in tons shipped while the shipments from the Decker and Black Butte mines reflected a modest increase over first quarter 1991. The Calvert mine has reached delivery levels of coal for its primary customer as required by contract. Continued significant increases in shipments from this mine are not anticipated in the near future. The increased shipments from the Decker and Black Butte mines reflect sales from new contracts and sales on the spot market. The average sales price per ton modestly increased due to the shipments from the Black Butte mine which have a higher contractual sales price per ton than the other mines.

The gross margin on mining revenue approximated 30% during the first quarter of 1992 compared to 23% during the same period in 1991. The increase in gross margin is the result of an upward adjustment to the sales price per ton on an existing contract and the negotiation of new contracts and spot market sales. The new contracts and spot market sales have enabled the various mines to increase productivity, thereby reducing the mining costs per ton and increasing the margin realized per ton.

See "Legal Proceedings" with respect to the Whitney Benefits case.

### Telecommunications

Telecommunications revenue increased significantly during 1992. The increase results from MFS' acquisition during the fourth quarter of 1991 of a majority interest in a telecommunications business which provides service to the greater Washington D.C. area and improved market penetration in the other cities where MFS operates. The 1992 revenue also increased as a result of KNT, which was included in the construction segment in 1991, being awarded several system integration contracts to design and install communication systems for its customers. Cost of services in excess of revenue in 1992 decreased as a result of improved operating efficiencies which have favorably impacted the fixed and variable costs associated with providing these services.

## Results of Operations - First Quarter 1992 vs. First Quarter 1991 (continued)

### Other Income

During the first quarter of 1992 and 1991, the Group recognized $14 million and $13 million of investment income, respectively. A gain of $2 million from the sale of approximately 6,000 acres of timberland was recognized in the first three months of 1992. During the same period in 1991, a gain of $1 million related to the sale of approximately 3,000 acres of timberlands was recognized. Gains and losses from other miscellaneous asset dispositions made up the remainder of Other Income.

### Selling and Administrative Expenses

Selling and administrative expenses are higher in the first quarter of 1992 as compared to first quarter of 1991 due primarily to higher mine management fees paid to the Construction & Mining Group and increased expenses in the telecommunications operations.

### Interest Expense

Interest expense for the first quarter of 1992 reflects the anticipated decrease due to the significant reductions during 1991 in both short-term borrowings and long-term debt. All short-term borrowings were repaid in July of 1991 and no new borrowings have been incurred. The Group also redeemed $150 million of debt in October of 1991 with no new material debt incurred since year-end 1991. The Group does not anticipate significant additions of short-term borrowings or long-term debt in the near future.

### Discontinued Packaging Businesses

The remaining earnings from discontinued operations result from the Group's equity investment in a plastics joint venture. Equity earnings from this investment were less than $1 million during the first quarter of 1992. Discontinued operations for the same period in 1991 primarily reflect earnings from packaging businesses which were sold subsequent to March 31, 1991. The adoption of Statement of Financial Accounting Standards ("SFAS") No 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions", partially offset 1991 first quarter earnings.

## KIEWIT DIVERSIFIED GROUP

### Financial Condition - March 31, 1992 vs. December 28, 1991

During the first three months of 1992, the Group repurchased 1.3 million shares of common stock for $62 million, paid dividends of $5 million and declared an additional $28 million of dividends ($1.35 per share). The Group also retired $8 million of debt due to former stockholders, received $30 million from United States Can Company and collected $12 million with respect to receivables from the 1991 sales of certain discontinued packaging operations. Additionally, the Group's common equity was increased by $48 million upon the conversion of 3 million shares of Class B&C stock into 1 million shares of Class D stock. The Group also invested $5 million for 447,500 shares of California Energy Company, Inc. common stock, bringing the Group's total investment to $99 million and ownership interest to approximately 19% at March 31, 1992. The Group has certain options to purchase additional shares of California Energy Company, Inc. common stock which it may choose to exercise in the future.

The Group's working capital position at the end of the first quarter of 1992, together with anticipated cash flows from operations, collection of receivables from the sales of various packaging operations and existing borrowing capacity, should be sufficient for the remainder of 1992's working capital and capital expenditure requirements. Subsequent to March 31, 1992, the Group purchased an additional 474,300 shares of California Energy Company, Inc. common stock for $6 million and collected $100 million in cash with respect to sales receivables when Plastic Containers, Inc. repaid a bridge note receivable prior to maturity. The Group anticipates that it will continue to invest between $5 million and $10 million annually in its mining businesses, make significant investments in its telecommunications and energy businesses and search for opportunities to acquire operating businesses that are capital intensive and provide for long-term growth. The Group has been investigating and will continue to investigate these opportunities and intends to make significant acquisitions. These investments, along with the payment of income taxes and the repurchases of common stock, are expected to be the significant long-term uses of liquidity. The Group's existing cash and cash equivalents, temporary investments, collection of sales receivables, cash flow from future operations and existing borrowing capacity are expected to provide sufficient liquidity to fund these expenditures.

The Group is currently required to adopt SFAS No. 109, "Accounting for Income Taxes", no later than 1993. The new standard would significantly change the method of accounting for income taxes. SFAS No. 109 permits, but does not require, restatement of previously issued financial statements. The Group has not yet elected the method, nor quantified the effect, of implementation on the financial statements.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings

Whitney Litigation. In 1974, a subsidiary of the Company ("Kiewit"), entered into a lease agreement with Whitney Benefits, Inc., a Wyoming charitable corporation ("Whitney"), under which Kiewit was granted the right to mine all of the coal owned by Whitney at a location in Sheridan County, Wyoming. Whitney retained the right to receive royalties from the sale of such coal by Kiewit. In August 1977, the Surface Mining Control and Reclamation Act was enacted. The Act prohibited surface coal mining in certain alluvial valley floors in the western U.S., including the Whitney property. In 1983, Kiewit and Whitney filed an action, now titled *Whitney Benefits, Inc. and Peter Kiewit Sons', Co. v. The United States*, in the U.S. Claims Court, seeking compensation for the taking of Whitney's royalty interest and Kiewit's interest in the coal reserves. In October 1989, the Claims Court ruled that a taking had occurred and awarded plaintiffs the 1977 fair market value of the property (calculated to be $60.3 million) plus interest. In February 1991, the U.S. Court of Appeals for the Federal Circuit affirmed the decision of the Claims Court. In November 1991, the U.S. Supreme Court denied certiorari. The effect of the denial was to leave intact the Claims Court decision.

The parties continue to litigate several issues. One issue is whether the plaintiffs are entitled to simple interest (approximately $93 million for the period August 1977 to March 1992) in addition to the $60.3 million, or to compound interest. The plaintiffs have jointly asked the Claims Court to require compound interest, which would more than double the simple interest amount.

On March 20, 1992, the government filed a motion in the Claims Court for a new trial to redetermine the value of the property. The government alleges that new evidence presented by the plaintiffs in a proceeding concerning allocation of the award between plaintiffs was inconsistent with testimony relied on by plaintiffs during the earlier trial on valuation issues and that for this reason an injustice has been done the United States. Kiewit and Whitney have urged the Claims Court to deny the government's motion.

In April 1992 the plaintiffs agreed that Kiewit will receive 67.5 percent and Whitney will receive 32.5 percent of any award. It is not presently known when these proceedings will be concluded, what amount will be awarded to Kiewit, nor when payment of that amount will occur.

### Item 2. Changes in Securities

On January 8, 1992, a Restated Certificate of Incorporation of the Company was filed with the State of Delaware. On that date the existing common stock of the Company was reclassified and exchanged for new common stock. Each existing share of Class B Common Stock, $.0625 par value, was exchanged for one share of Class B Construction & Mining Group Nonvoting Restricted Redeemable Convertible Common Stock, $.0625 par value, and one share of Class D Diversified Group

Item 2. (continued)

Convertible Exchangeable Common Stock, $.0625 par value. Each existing share of Class C Common Stock, $.0625 par value, was exchanged for one share of Class C Construction & Mining Group Restricted Redeemable Convertible Exchangeable Common Stock, $.0625 par value, and one share of Class D Diversified Group Convertible Exchangeable Common Stock. $.0625 par value. A Registration Statement on Form S-4 relating to this matter was declared effective by the Securities and Exchange Commission on November 5, 1991. The Consent Statement and Prospectus filed as part of that Registration Statement, which has been furnished to all stockholders, contained detailed and summary information describing the rights of the holders of the existing and proposed classes of securities. A brief statement of the general effect of such modifications upon the rights of holders of such securities can be satisfied by reference to Page 1, "Summary of D Stock Proposal", and Page 2 "Summary of Material Risks of D Stock", of that Consent Statement and Prospectus, which pages are hereby incorporated by reference.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits filed as part of this report are listed below.

| Exhibit Number | |
|---|---|
| 28 | Pages 1 and 2 of the Consent Statement and Prospectus, a part of the Company's Registration Statement on Amendment No. 1 to Form S-4 filed November 4, 1991 (SEC File No. 33-43519). |

(b) Report on Form 8-K filed January 23, 1992 reported the stockholder approval of the D Stock Proposal and the reclassification and exchange of the Company's common stock, effective January 8, 1992.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PETER KIEWIT SONS', INC.

Dated: May 14, 1992

Robert E. Julian
Executive Vice President
Chief Financial Officer

EXHIBIT 28

Page 1, "Summary of D Stock Proposal" and Page 2, "Summary of Material Risks of D Stock" of the Consent Statement and Prospectus, a part of the Company's Registration Statement on Amendment No. 1 to Form S-4 filed November 4, 1991 (SEC File No. 33-43519).

## Summary of D Stock Proposal

*The following summary is qualified in its entirety by the detailed information and financial statements appearing elsewhere in the Consent Statement. See Annex I for a Glossary of Capitalized Terms used in this Consent Statement.*

| | Existing Common Stock | New B&C Stock | New D Stock |
|---|---|---|---|
| Business | | Construction and mine management. | Diversified businesses: packaging, telecommunications, energy production, coal mining. |
| Voting Rights | Class B Stock: Nonvoting<br>Class C Stock: One vote per share | B Stock: Nonvoting.<br>C Stock: One vote per share. | One vote per share. |
| • Board of Directors | 2/3 of Board must be "inside" directors.<br>Elected by cumulative voting. | 2/3 of directors elected by C Stock.<br>4/5 of C directors must be "inside".<br>Elected by cumulative voting. | 1/3 of directors elected by D Stock.<br>No cumulative voting. |
| • Supermajority Requirements | 80% vote required to approve fundamental corporate matters: changes in stock formula, permitting a public offering or sale of stock to nonemployees, certain mergers, dissolutions, sale of substantially all of Company's assets, and changes to the capital structure. | 80% vote of C Stock plus majority of Voting Stock (C Stock and D Stock combined) required to approve fundamental corporate changes. | Majority of Voting Stock (which includes D Stock) must approve fundamental corporate changes. Separate class vote required in certain circumstances. |
| • Equalizing Stock Dividends | No provision. | Board can declare stock dividends on C Stock, increasing number of aggregate C Stock votes, without corresponding stock dividends on D Stock. | — |
| Formula Price | Per share price is based on stock formula, which is the Company's consolidated stockholders' equity, less the value of construction equipment. | Class B&C Per Share Price is based on B&C Formula Value, which is the Company's consolidated stockholders' equity, less the value of construction equipment, and less the Class D Formula Value. | Class D Per Share Price is based on Class D Formula Value, which is the stockholders' equity of Diversified Group, plus one-half of the unconsolidated stockholders' equity of PKS itself and any Non-Operating Subsidiaries (e.g. PKS Information Services, Inc.) |
| Dividends | Policy is to pay 15-20% of consolidated earnings as cash dividends. | Policy is to pay 15-20% of consolidated earnings as cash dividends. | No dividend policy established. Dividends cannot exceed Class D Formula Value. |
| Liquidation | In the event of liquidation, Class B Stock is paid $0.36 per share, then Class C Stock is paid $0.36 per share, then remaining assets are divided on an equal per share basis. | In the event of liquidation, from the assets remaining for distribution to the common stockholders, the Board will establish two accounts. The D Liquidation Account will be in an amount equal to the value of the Diversified Group's assets, plus an amount equal to one-half of the unconsolidated stockholders' equity of PKS itself and any Non-Operating Subsidiaries. The B&C Liquidation Account will be the value of the remaining assets. First, B&C Stockholders will receive an amount equal to $1.00 per share, reducing the B&C Liquidation Account. Second, D Stockholders will receive an amount equal to $2.00 per share, reducing the D Liquidation Account. Finally, any assets remaining in the B&C Account shall be distributed to the B&C Stockholders and any assets remaining in the D Account shall be distributed to the D Stockholders. | |
| Mandatory Exchanges | No provision. | Board can require exchange of B&C Stock for shares of a Wholly-Owned Subsidiary that holds all the assets and liabilities of the Construction & Mining Group. | Board can require exchange of D Stock for shares of a Wholly-Owned Subsidiary that holds all the assets and liabilities of the Diversified Group.<br>Board can require an exchange of all D Stock for C Stock, unless D Stock is Publicly Traded. If D Stockholders are not eligible to own C Stock, the Company must repurchase D Stock for cash. |
| Ownership and Transfer Restrictions | Ownership by employees only (with exceptions). Stock must be resold to Company upon death or termination of employment.<br>Sales by or to the Company only. | Ownership by employees only (with exceptions). Stock must be resold to Company upon death or termination of employment, except that stock of employees retiring at year end may be converted into D Stock.<br>Sales by or to the Company only. | No restrictions on ownership and transfer. |
| Repurchase Obligations | Company must repurchase upon demand at formula price. | Company must repurchase upon demand at Class B&C Per Share Price | Company must repurchase upon demand at Class D Per Share Price, unless and until D Stock is Publicly Traded. |
| | | Board can suspend obligation to repurchase for period up to one year. | Board can suspend obligation to repurchase for period of up to one year.<br>Board can limit cash repurchase duties by offering payment in form of two-year promissory note. |
| Redemption | Class B Stock: At Board discretion, redeemable at formula price.<br>Class C Stock: Board can require resale of "excessive amounts" of stock, based on level of employee's contribution, effort, and responsibility. | B Stock: At Board discretion, redeemable at Class B&C Per Share Price.<br>C Stock: Board can require resale of "excessive amounts" of stock, based on level of employee's contribution, effort, and responsibility. | No provision. |
| Conversion Rights | No provision. | Holders can convert B&C Stock to D Stock on each January 1 and on 75th day after Effective Date. | Holders can convert D Stock into C Stock in connection with an offering of C Stock (conversion limited to value of new C Stock offered). |

## Summary of Material Risks of D Stock

*The following is a summary of the material risks of owning D Stock as compared to owning B&C Stock. It does not purport to summarize all the risks relating to the D Stock Proposal generally. The differing attributes of the B&C Stock and the D Stock are outlined in the "Summary of D Stock Proposal" on the previous page. The following summary is qualified in its entirety by the detailed information and financial statements appearing elsewhere in the Consent Statement. See Annex I for a Glossary of Capitalized Terms used in this Consent Statement.*

| | New B&C Stock | New D Stock |
|---|---|---|
| Voting Rights<br>• Board of Directors | C Stock elects 2/3 of directors | D Stock elects only 1/3 of the directors, even though the initial Class D Formula Value may be 70-75% of the combined Class B&C and Class D Formula Values. Since most Board matters require simple majority voting, C Directors could control such decisions. |
| • Supermajority Requirements | 80% of C Stock plus majority of Voting Stock (C Stock & D Stock combined) required to approve fundamental corporate matters. | C Stock effectively controls the approval of fundamental corporate changes. |
| • Equalizing Stock Dividends | The Board can declare stock dividends on C Stock without declaring commensurate D Stock dividends, so that the number of shares of C Stock will equal the number of outstanding shares of D Stock. | The Board (2/3 of which is elected by holders of C Stock) may increase the proportion of Voting Stock attributable to C Stock, thereby diluting the relative voting strength of D Stock. Although fundamental matters require approval of 80% of the C Stock, a majority of the Voting Stock is also required. The "Equalizing Stock Dividends" provision makes it difficult for D Stock to block fundamental corporate proposals which are favored by 80% of the C Stockholders, even if most D Stock is held by a cohesive voting group. |
| Liquidation | After allocating assets to the two Liquidation Accounts, the B&C Stock is first paid a value of $1.00 per share. | The liquidation preference for the B&C stockholders might exhaust the remaining assets so that the D Stockholders would receive nothing in liquidation. However, holders of D Stock are next entitled to receive $2.00 per share before any further distribution to holders of B&C Stock. |
| Mandatory Exchange | | The board can require a mandatory exchange of D Stock for C Stock. If a holder of D Stock is not eligible to own C Stock (because the holder is not a Company employee), D Stock must be resold for cash at the formula price. The mandatory exchange can be caused by the Board without a vote of the Stockholders. Thus, holders can be forced to sell D Stock even though they may wish to retain such stock. |
| Repurchase Obligations | | If more than 10% of D shares are tendered for repurchase in a year, the Board may elect to satisfy repurchase obligations by delivering a two-year promissory note instead of cash. This provision is applicable only to D Stock, not to B&C Stock. The D Stockholders have risk that under adverse financial circumstances during the two-year period, the Board would continue to repurchase B&C stock for cash, thus depleting the Company's resources, or that the Company would otherwise incur losses, in either case increasing the credit risk of such "D noteholders". |
| Conversion Rights | B&C Stock generally can be converted into D Stock at the end of each year. | Holders can convert D Stock into C Stock only in connection with an offering of C Stock to employees. Conversions are limited to the value of C Stock offered, if any. |
| Public Trading | | D Stock can become Publicly Traded without a vote of the holders of D Stock. Public Trading eliminates the Company's duty to repurchase D Stock. If the Company is not required to repurchase D Stock, holders of D Stock have the risk that there will not be a sufficient number of willing buyers to provide an efficient public market, with resulting price uncertainties. |
| General Risk | • The Board is authorized to take a number of actions which could result in disparate treatment between classes of stock. These actions include: (1) payment of dividends; (2) issuance of new shares; (3) suspension of repurchase obligations; (4) transfers of assets to satisfy legal liabilities; and (5) pursuit of new corporate opportunities.<br>• Immediately after the exchange, the holders of B&C Stock and D Stock will be identical. Any "disadvantage" of owning D Stock is balanced by the "advantage" of owning B&C Stock. Over time, individual holders may vary their proportions of B&C Stock and D Stock, and in the aggregate, the holders of B&C Stock and D Stock will change because of stock transactions.<br>• These general risks may be greater risks for D Stockholders than B&C Stockholders if the Board (which has more C than D directors) exercises its discretion to take actions which favor the C Stock to the detriment of the D Stock. However, the Board has a fiduciary duty to act with due care in the best interests of all stockholders, regardless of class. | |

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# SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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## FORM 10-Q

☒ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

☐ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

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For Quarter Ended March 31, 1992 Commission File N

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LAFAYETTE AMERICAN BANCORP, INC.
(Exact name of Registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of incorporation or organization)

06-1189467
(IRS employer identification no.)

2321 Whitney Avenue, Hamden, Connecticut
(Address of principal executive offices)

06518
(Zip Code)

Registrant's telephone number, including area code (203) 287-3545

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No ___

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

Common stock $1.00 par value - 3,500,916 shares as of May 1, 1992

# LAFAYETTE AMERICAN BANCORP, INC.

## FORM 10-Q

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## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

### CONSOLIDATED BALANCE SHEET
Lafayette American Bancorp, Inc. and Subsidiaries

| (dollars in thousands) | March 31, 1992 (unaudited) | December 31, 1991 (Note 2) |
|---|---|---|
| **Assets** | | |
| Cash and Due From Banks | $ 33,163 | $ 33,317 |
| Interest-Bearing Deposits with Banks | 3,961 | 2,368 |
| Federal Funds Sold | 2,350 | 1,130 |
| Trading Account Securities | - | - |
| Investment Securities (market value of $159,629 in 1992 and $168,902 in 1991) | 162,458 | 164,725 |
| Loans | 499,911 | 512,486 |
| Less Reserve for Possible Loan Losses | (15,808) | (14,209) |
| Net Loans | 484,103 | 498,277 |
| Accrued Interest Receivable | 6,754 | 5,967 |
| Premises and Equipment | 7,788 | 8,066 |
| Other Real Estate Owned, Net of Reserve for Real Estate Losses of $335 in 1991 | 19,361 | 19,033 |
| Other Assets | 13,484 | 26,810 |
| Total Assets | $733,422 | $759,693 |
| **Liabilities and Shareholders' Equity** | | |
| Liabilities: | | |
| Deposits: | | |
| Demand | $102,374 | $117,158 |
| NOW | 63,048 | 59,079 |
| Savings | 237,146 | 204,773 |
| Money Market | 45,789 | 43,599 |
| Time | 219,388 | 238,240 |
| Total Deposits | 667,745 | 662,849 |
| Repurchase Agreements and Other Borrowed Funds | 26,086 | 46,197 |
| Other Liabilities | 5,750 | 13,438 |
| Total Liabilities | 699,581 | 722,484 |
| Commitments and Contingencies (Note 1) | | |
| Shareholders' Equity: | | |
| Preferred Stock - par value $1 per share: Authorized 275,000 shares, none issued | - | - |
| Common Stock - par value $1 per share: Authorized 6,000,000 shares, issued and outstanding 3,500,916 in 1992 and 1991 | 3,501 | 3,501 |
| Capital Surplus | 25,289 | 25,289 |
| Retained Earnings | 5,051 | 8,419 |
| Total Shareholders' Equity | 33,841 | 37,209 |
| Total Liabilities and Shareholders' Equity | $733,422 | $759,693 |

The accompanying notes are an integral part of these financial statements.

PART I - FINANCIAL INFORMATION - Continued

## CONSOLIDATED STATEMENT OF OPERATIONS
Lafayette American Bancorp, Inc. and Subsidiaries

| (dollars in thousands, except per share data) | Three Months Ended March 31, 1992 | Three Months Ended March 31, 1991 |
|---|---|---|
| | (unaudited) | |
| **Interest Income** | | |
| Interest and Fees on Loans | $11,386 | $14,355 |
| Interest and Dividends on Investment Securities: | | |
| Taxable | 2,813 | 2,513 |
| Nontaxable | 273 | 570 |
| Interest on Deposits with Banks | 34 | 77 |
| Interest on Federal Funds Sold | 52 | 99 |
| Interest on Trading Account Securities | 8 | 14 |
| Total Interest Income | 14,566 | 17,628 |
| **Interest Expense** | | |
| Interest on Deposits | 6,448 | 9,781 |
| Interest on Short-Term Borrowings | 310 | 552 |
| Total Interest Expense | 6,758 | 10,333 |
| Net Interest Income | 7,808 | 7,295 |
| Provision for Possible Loan Losses | 3,079 | 1,170 |
| Net Interest Income After Provision for Possible Loan Losses | 4,729 | 6,125 |
| **Noninterest Income** | | |
| Service Charges on Deposit Accounts | 772 | 642 |
| Trust Income | 315 | 180 |
| Commissions and Fees | 187 | 161 |
| Investment Securities Gains, Net | 126 | 1,153 |
| Mortgage Servicing Fees | 32 | 27 |
| Gains on Sales of Loans | 31 | 48 |
| Net Trading Account Profits (Losses) | (237) | 5 |
| Total Noninterest Income | 1,226 | 2,216 |
| **Noninterest Expense** | | |
| Salaries | 2,573 | 2,501 |
| Employee Benefits | 698 | 846 |
| Losses on Securities Commitments | 1,375 | - |
| Foreclosed Properties Provision and Expense | 1,018 | 204 |
| Net Occupancy | 907 | 951 |
| Furniture and Equipment | 543 | 532 |
| Supply and Communication | 396 | 405 |
| FDIC Insurance | 373 | 314 |
| Business Development | 198 | 199 |
| Other | 1,232 | 1,027 |
| Total Noninterest Expense | 9,313 | 6,979 |
| Income (Loss) Before Income Taxes and Extraordinary Item | (3,358) | 1,362 |
| Provision for Income Taxes | 10 | 280 |
| Income (Loss) Before Extraordinary Item | (3,368) | 1,082 |
| Extraordinary Item - Utilization of Net Operating Loss Carryforward | - | 270 |
| Net Income (Loss) | $(3,368) | $ 1,352 |
| Average Shares Outstanding | 3,500,916 | 3,500,916 |
| Per Common Share: | | |
| Income (Loss) Before Extraordinary Item | $(.96) | $.31 |
| Net Income (Loss) | (.96) | .39 |

The accompanying notes are an integral part of these financial statements.

PART I - FINANCIAL INFORMATION - Continued

## CONSOLIDATED STATEMENT OF CASH FLOWS
Lafayette American Bancorp, Inc. and Subsidiaries

| (dollars in thousands) | Three Months Ended March 31, 1992 | 1991 |
|---|---|---|
| | (unaudited) | |
| **Operating Activities** | | |
| Net Income (Loss) | $ (3,368) | $ 1,35 |
| Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by Operating Activities: | | |
| Provision for Possible Loan Losses | 3,079 | 1,17 |
| Provision for Losses on Other Real Estate Owned | 705 | 9 |
| Depreciation and Amortization | 444 | 41 |
| Investment Securities Gains, Net | (126) | (1,15 |
| Unrealized Losses on Securities Commitments | 712 | - |
| Net Trading Account Activity | 237 | ( |
| Gains on Sales of Loans | (31) | (4 |
| Increase in Accrued Interest Receivable | (787) | (13 |
| Decrease in Accrued Interest Payable | (64) | (36 |
| Other, Net | 4,431 | (1,93 |
| Net Cash Provided by (Used for) Operating Activities | 5,232 | (60 |
| **Investing Activities** | | |
| Proceeds from Sales of Investment Securities | 9,795 | 45,02 |
| Proceeds from Maturities of Investment Securities | 4,396 | 5,97 |
| Purchases of Investment Securities | (11,859) | (54,77 |
| Net Decrease in Loans | 10,403 | 4,82 |
| Purchases of Premises and Equipment | (93) | (16 |
| Net Cash Provided by Investing Activities | 12,642 | 88 |
| **Financing Activities** | | |
| Net Increase (Decrease) in Demand, NOW, Savings and Money Market Accounts | 23,748 | (1,13 |
| Net Decrease in Time Deposits | (18,852) | (5,51 |
| Net Increase (Decrease) in Federal Funds Purchased and Securities Sold Under Repurchase Agreements | (20,633) | 3,26 |
| Net Increase (Decrease) in Other Borrowed Funds | 522 | (35 |
| Net Cash Used for Financing Activities | (15,215) | (3,74 |
| Net Increase (Decrease) in Cash and Cash Equivalents | 2,659 | (3,46 |
| Cash and Cash Equivalents at Beginning of Year | 36,815 | 40,93 |
| Cash and Cash Equivalents at End of Year | $ 39,474 | $ 37,52 |
| **Supplemental Information on Cash Paid For:** | | |
| Interest | $6,822 | $10,69 |
| Income Taxes | - | 1 |
| **Noncash Investing and Financing Activities:** | | |
| Transfer from Loans to Other Real Estate Owned | 2,172 | 58 |

The accompanying notes are an integral part of these financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Lafayette American Bancorp, Inc. and Subsidiaries
March 31, 1992 (unaudited) and December 31, 1991

## Note 1 - Regulation and Supervision

The Board of Directors of Lafayette Bank and Trust Company (Lafayette), a wholly-owned subsidiary of Lafayette American Bancorp, Inc. (the Company), at the request of the State of Connecticut Banking Department (the "State"), entered into a Stipulation and Agreement (the "Agreement") with the State dated June 17, 1991. The Agreement requires Lafayette to (i) obtain prior regulatory approval before paying dividends, (ii) increase its Tier 1 leverage capital ratio to 6% by September 16, 1992 (at March 31, 1992, Lafayette's Tier 1 leverage capital was $15,099,000 and its Tier 1 leverage capital ratio was 4.35%) and maintain that ratio during the remaining term of the Agreement, (iii) establish an operating plan to improve profitability, asset quality and capital, (iv) maintain an adequate reserve for possible loan losses, (v) resolve outstanding asset quality concerns and (vi) retain competent management at all levels of responsibility to manage and supervise Lafayette. Management expects that Lafayette will comply with all requirements of the Agreement, except that the required Tier 1 leverage capital ratio of 6% will probably not be achieved by September 16, 1992.

During the fourth quarter of 1991, Lafayette was jointly examined by the Federal Deposit Insurance Corporation (the "FDIC") and State. All known adjustments resulting from this regular examination were recognized in its December 31, 1991 financial statements. In connection with this examination, management may be asked to consent voluntarily to an FDIC Cease and Desist Order (the "Order") which management believes has become fairly standard in banks with high levels of nonperforming assets and a leverage capital ratio under 5%. Management does not know, and cannot predict, the specific items that will be addressed in the Order. However, based on initial conversations with the FDIC and State, management anticipates that such regulatory action may require Lafayette to adhere to similar provisions as required under its current Agreement. The Order may contain different capital requirements and dates from the existing Agreement.

During the fourth quarter of 1991, American National Bank (American), a wholly-owned subsidiary of the Company, was examined by the Comptroller of the Currency (the "Comptroller") and the FDIC. All known adjustments resulting from these examinations were recognized in its December 31, 1991 financial statements. In connection with the examination by the Comptroller (American's primary regulator), management was notified by letter dated April 29, 1992 that American will be asked to enter into the Issuance of a Consent Order ("Consent Order"). Based on the initial document presented to American by the Comptroller which is in the process of negotiation, American would be required to (i) increase its Tier 1 leverage capital ratio to 6% within 90 days from execution of the Consent Order, (ii) establish a compliance committee of the Board to ensure compliance with the Consent Order, (iii) retain an outside consultant to evaluate senior management, Bank policies and make recommendations, (iv) establish strategic and operating plans to improve profitability, asset quality, loan administration and capital, (v) develop or revise certain policies regarding loan and credit administration, including revising appraisal procedures where appropriate and required, and procedures regarding asset and liability management and investments, (vi) maintain an adequate reserve for possible loan losses, (vii) conduct a review by the compliance committee of the adequacy of the reserve for possible loan losses at each quarter end during 1991 and restate prior Call Reports if required by this review, (viii) obtain prior regulatory approval before paying dividends to the Company and (ix) correct certain violations of law, rule or regulation cited in the Report of Examination. It is unlikely that American will be able to recommence paying dividends until it has satisfied any capital requirements which may be imposed pursuant to the anticipated agreement and established a sustained period of profitability.

Although management cannot predict the ultimate impact of the agreements referred to above until the terms of such agreements are finalized and relevant time frames are established, management believes that it has already made progress since the examination dates in the direction of resolving some of the concerns leading to these proposed agreements. Management believes that it could employ several strategies to increase each subsidiary Bank's regulatory capital ratios within a reasonable period of time, including asset sales, reducing the Bank's asset base, further centralization of management activities, raising additional capital through a private placement or public offering of securities or any combination thereof, although no management assurances can be given that any such steps will be successful.

The Comptroller, during its regular 1991 examination of American, initially contested American reporting its unamortized mortgage servicing rights as an intangible asset the value of which would be includable in regulatory capital. The Comptroller has now advised in writing that if certain changes to this transaction are made, it will allow American to continue to carry the unamortized value of this asset on its books and utilize it in calculating regulatory capital ratios. American intends to make the changes necessary, and the Company has included the unamortized mortgage servicing rights in computing its capital ratios. The risk-based capital ratios as of March 31, 1992 for the Company, American and Lafayette were 7.77%, 7.55% and 7.90%, respectively, and the leverage capital ratios were 4.42%, 4.41% and 4.35%, respectively. If the unamortized mortgage servicing rights intangible asset was deducted from regulatory capital, the risk-based capital ratios for the Company, American and Lafayette would have been 7.03%, 6.20% and 7.90%, respectively, and the leverage capital ratios would have been 3.89%, 3.40% and 4.35%, respectively.

As of March 31, 1992, the Company did not have the ability to pay dividends as the result of Federal and state law restrictions on the ability of American and Lafayette to pay dividends to the Company.

## Note 2 - Basis of Presentation

The consolidated balance sheet as of March 31, 1992, the consolidated statement of operations for the three month periods ended March 31, 1992 and 1991, and the consolidated statement of cash flows for the three month periods ended March 31, 1992 and 1991 have been prepared by the Company without audit. Certain reclassifications have been made to the 1991 financial statements to conform with the 1992 presentation. In the opinion of management, the financial statements have been prepared in conformity with generally accepted accounting principles for interim financial statements and include all adjustments necessary to present fairly the financial position of the Company and its subsidiaries as of March 31, 1992, and the results of their operations and their cash flows for the three month periods ended March 31, 1992 and 1991.

The consolidated balance sheet as of December 31, 1991, which has been included for comparative purposes, has been condensed from the audited financial statements for the year then ended. Certain information and footnote disclosures normally included in financial statements presented in accordance with generally accepted accounting principles have been condensed or omitted. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 1991. The Company's Form 10-K is on file with the Securities and Exchange Commission and is incorporated herein by reference.

## Note 3 - Investment Securities

The carrying and estimated market values of investment securities were:

| | March 31, 1992 | | December 31, 1991 | |
|---|---|---|---|---|
| | Carrying Value | Estimated Market Value | Carrying Value | Estimated Market Value |
| | (dollars in thousands) | | | |
| U.S. Treasury | $ 44,157 | $ 42,641 | $ 42,671 | $ 43,596 |
| U.S. Government agencies: | | | | |
| Mortgage-backed securities | 93,133 | 91,486 | 93,548 | 96,390 |
| Other | 5,245 | 5,309 | 6,162 | 6,298 |
| Obligations of states and political subdivisions | 15,554 | 15,810 | 16,756 | 17,067 |
| Other bonds, notes and debentures | 3,376 | 3,390 | 4,595 | 4,558 |
| Total debt securities | 161,465 | 158,636 | 163,732 | 167,909 |
| Marketable equity securities | 1,088 | 993 | 1,088 | 993 |
| Net unrealized loss on marketable equity securities | (95) | - | (95) | - |
| Total | $162,458 | $159,629 | $164,725 | $168,902 |

## PART I - FINANCIAL INFORMATION - Continued

### Note 4 - Loans

The composition of the loan portfolio was:

| | March 31, 1992 | December 31, 1991 |
|---|---|---|
| | (dollars in thousands) | |
| Commercial loans | $207,368 | $211,322 |
| Real estate loans: | | |
| Commercial and other | 133,891 | 140,219 |
| 1-4 Family residential | 88,713 | 87,587 |
| Construction | 16,644 | 16,792 |
| Installment loans | 53,295 | 56,566 |
| Total | 499,911 | 512,486 |
| Less - Reserve for possible loan losses | 15,808 | 14,209 |
| Loans, net | $484,103 | $498,277 |

### Note 5 - Nonperforming Assets

The balances of nonperforming assets were:

| | March 31, 1992 | December 31, 1991 |
|---|---|---|
| | (dollars in thousands) | |
| Nonaccrual loans | $32,205 | $32,521 |
| Accruing loans past due 90 days or more as to principal or interest | 1,739 | 1,969 |
| Restructured loans | 1,924 | 2,792 |
| Total nonperforming loans | 35,868 | 37,282 |
| Other real estate owned | 19,361 | 19,368 |
| Total nonperforming assets | $55,229 | $56,650 |
| As a percentage of total loans and other real estate owned | 10.63% | 10.65% |

## PART I - FINANCIAL INFORMATION - Continued

### Note 6 - Reserve for Possible Credit Losses

Changes in the reserves for possible credit losses were:

| | Three Months Ended March 31, | |
|---|---|---|
| | 1992 | 1991 |
| | (dollars in thousands) | |
| Reserve for possible loan losses: | | |
| Balance, beginning of year | $14,209 | $ 9,560 |
| Provision charged to expense | 3,079 | 1,170 |
| Recoveries | 133 | 136 |
| Loans charged off | (1,613) | (417) |
| Balance, end of period | $15,808 | $10,449 |
| Reserve for other real estate owned losses: | | |
| Balance, beginning of year | $ 335 | $ 1,000 |
| Provision charged to expense | 705 | 93 |
| Real estate charged off | (1,040) | (93) |
| Balance, end of period | $ - | $ 1,000 |

### Note 7 - Per Common Share Data

Per common share data for the three month periods ended March 31, 1992 and 1991 are based upon the weighted average number of shares outstanding during the periods. The effect of exercisable stock options in 1992 and 1991 was anti-dilutive and therefore not reflected in the computation of per common share amounts.

PART I - FINANCIAL INFORMATION - Continued

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### COMPARISON OF THE THREE MONTH PERIODS ENDED MARCH 31, 1992 AND 1991

Summary - For the three months ended March 31, 1992, the Company reported a net loss of $3,368,000 or $.96 per common share compared to net income of $1,352,000 or $.39 per common share for the same period in 1991. The Company operates primarily in Connecticut which since 1989 has been affected severely by a decline in economic conditions and a deterioration of the real estate market. The economic deterioration is in a large part the result of overbuilt real estate facilities causing declines in values, which has had an adverse economic effect on companies doing business in the area as well as causing an exodus of business and industry and rising unemployment. The worsening conditions have adversely affected banks throughout the Northeast, and prospects as to the extent and timing of future improvement in the economy remain uncertain. These conditions could result in the Company experiencing future increases in nonperforming assets, additional lost interest income on nonperforming assets and a need for further significant provisions for loan and real estate losses. The amounts provided by the Company as provisions for possible loan losses were $3,079,000 for the first quarter of 1992 compared to $1,170,000 for the same period in 1991. The reserve for possible loan losses, after charge-offs and recoveries, increased from $10,449,000 as of March 31, 1991 to $15,808,000 as of March 31, 1992. In addition, the Company provided $705,000 in 1992 and $93,000 in 1991 as provisions for losses on other real estate owned.

As a result of these continued economic problems in the Company's lending areas, nonperforming assets increased to $55,229,000 as of March 31, 1992 from $40,119,000 as of March 31, 1991. On a company wide basis, nonperforming assets at the end of the first quarter of 1992 appears to have leveled off and in fact declined slightly from $56,650,000 as of December 31, 1991, although on an individual basis fluctuations occur at the subsidiary Banks as they are in different market areas. Net loan charge-offs and losses on the write-downs of other real estate owned increased from $374,000 in the first three months of 1991 to $2,520,000 for the same period in 1992. The carrying value of other real estate owned as of March 31, 1992 was $19,361,000 versus $19,915,000 as of March 31, 1991.

In 1991, the Company was able to recognize significant security gains by exchanging high coupon GNMA mortgaged-backed securities ("GNMA") for lower coupon GNMA's as interest rates dropped. Management's strategy was that the likelihood of prepayments in the high coupon GNMA's was greater as market interest rates declined. By exchanging into lower coupons, principal was retained and invested at a better yield than would be available when anticipated future prepayments would occur.

In line with this overall strategy, in January 1992, Lafayette entered into commitments to purchase approximately $60 million of 7.50% coupon GNMA'S for settlement in April 1992, but in March determined not to go forward with the execution of the commitments. As of March 31, 1992, $27 million of the commitments were sold at a loss of $663,000. The remaining $33 million of commitments were adjusted to the lower of cost or market which resulted in an unrealized loss of $712,000 bringing the total loss recorded by Lafayette as of March 31, 1992 to $1,375,000. Subsequently, the remaining $33 million of commitments were systematically liquidated by April 10, 1992 but the actual loss was $402,000 less than anticipated as of March 31, 1992. The $402,000 difference between the realized loss in April and the unrealized loss recorded as of March 31, 1992, will be reflected in second quarter earnings.

Other security gains of $126,000 exclusive of the GNMA 7.50% commitment losses were realized in the first quarter of 1992 compared to $1,153,000 during the same period last year.

The Company's aggregate market value of investment securities was below book value by $2,829,000 as of March 31, 1992. As of December 31, 1991, the aggregate market value exceeded book value by $4,177,000.

For further information regarding certain regulatory examinations, see Note 1 of Notes to Consolidated Financial Statements.

Net Interest Income - Net interest income, the difference between interest earned on interest-earning assets and interest expense incurred on interest-bearing liabilities, is a very significant component affecting the Company's earnings. Net interest income is affected by changes in the volumes and rates of interest-earning assets and interest-bearing liabilities, the volume of interest-earning assets funded with low cost deposits, noninterest-bearing deposits and shareholders' equity, and the level of nonperforming assets.

The following table, presented on a tax equivalent basis, summarizes net interest income, as reflected in the schedule presented on page 19, for the three months ended March 31, 1992 and 1991. The effects of the changes in volume and interest rates on net interest income during the three months ended March 31, 1992 and 1991 are shown in the schedule on page 20. Interest income on securities of states and political subdivisions, certain loans, and dividends on preferred stocks are partially exempt from Federal income tax. A tax equivalent adjustment has been made to income received from these sources to provide comparability to taxable income. All tax equivalent adjustments are computed using a 34% tax rate.

| | Three Months Ended March 31, | | Change From Prior Year | |
|---|---|---|---|---|
| | 1992 | 1991 | Amount | Percent |
| | (dollars in thousands) | | | |
| Interest income........ | $14,711 | $17,941 | $(3,230) | (18.0)% |
| Interest expense....... | 6,758 | 10,333 | (3,575) | (34.6) |
| Net interest income.... | $ 7,953 | $ 7,608 | $ 345 | 4.5 |

Average interest-earning assets were $679,121,000 and $693,357,000 for the three months ended March 31, 1992 and 1991, respectively. Average nonaccrual loans outstanding totaled approximately $32,363,000 and $8,675,000 for the three months ended March 31, 1992 and 1991, respectively, and are included in these amounts. The Company would have recorded approximately $728,000 and $233,000 of additional interest income if interest on nonaccrual loans had been recognized during the first three months of 1992 and 1991, respectively.

PART I - FINANCIAL INFORMATION - Continued

The Company's net interest margin, on a tax equivalent basis, was 4.14% for the quarter ended March 31, 1992 compared to 3.62% for the same period in 1991. The ratio of net interest income, on a tax equivalent basis, to average interest-earning assets was 4.71% for the three months ended March 31, 1992 compared to 4.45% for 1991.

A proportionately greater decline in interest rates on sources of funds compared with yields on earning assets concurrent with an improvement in the mix of deposits, partially offset by the effects of an increased amount of nonaccrual loans and a decline in average noninterest-bearing demand deposits, helped to achieve the increase in net interest income during 1992 compared to 1991.

Provision for Possible Loan Losses - The current economic conditions and deterioration of the real estate market in Connecticut has led management to increase its charge against earnings for the provision for possible loan losses to $3,079,000 for the first three months of 1992 from $1,170,000 in 1991. Net charge-offs totaled $1,480,000 for the first three months of 1992 compared to $281,000 for the same period in 1991. The reserve for possible loan losses was $15,808,000 or 3.16% of outstanding loans as of March 31, 1992 compared to $10,449,000 or 2.00% of outstanding loans as of March 31, 1991. Nonperforming loans were $35,868,000 as of March 31, 1992 and $19,204,000 as of March 31, 1991, representing 7.17% and 3.68%, respectively, of outstanding loans. The reserve coverage on nonperforming loans increased to 44.1% in 1992 from 38.1% at year end 1991 and decreased from 54.4% at March 31, 1991.

While considerable uncertainty exists as to the extent and timing of changes in the real estate market and the economy, the Company anticipates nonperforming assets to continue at the current level during 1992. If further economic deterioration continues in future periods, this might result in the Company experiencing increased levels of nonperforming assets, charge-offs, additional provisions for possible loan losses and a reduction in net interest income. The Company believes that its underwriting standards used in granting and renewing credit, continued monitoring of the collateral positions on all loans and real estate owned together with the consolidation of loan workouts and the management thereof at the holding company level, and assigning the disposition of other real estate owned to the centralized asset quality division will help reduce the future loss potential associated with any increases in nonperforming assets.

The reserve for possible loan losses is established by management and approved by the Board of Directors. Its adequacy is monitored based on independent internal and external credit review and analysis of the loan portfolio at each subsidiary Bank through a separate credit review function which considers current economic conditions and their probable effect on borrowers, the amount of nonperforming loans and related collateral, the amount of charge-offs during the period and other relevant factors.

Noninterest Income - Total noninterest income decreased by $990,000, or 44.7%, for the three months ended March 31, 1992 compared to the same period in 1991. Gains on the sales of securities decreased by $1,027,000. Also, see "Summary" section on pages 11 and 12 for an explanation of losses on securities commitments of $1,375,000 incurred during the first quarter of

1992. Service charges on deposit accounts increased $130,000, or 20.2% to $772,000 in 1992 from $642,000 in 1991, primarily as a result of price increases.

Trust income was $315,000 in 1992 compared to $180,000 in 1991, an increase of $135,000 or 75.0% as a result of increasing the Company's volume partially through the purchase of Professionally Managed Investment Accounts (PMIA) from another institution in March 1991 and partially through an intensive new business campaign by the Company to increase the size and number of accounts in its investment management portfolio.

The net trading account losses of $237,000 recorded by the Company in 1992 were primarily related to unrealized losses on interest rate swaps due to changes in market value.

Noninterest Expense - Operating expenses increased $2,334,000 or 33.4% to $9,313,000 in 1992 from $6,979,000 in 1991. The table below includes the primary contributors to this increase, the bulk of which resulted from losses on securities commitments and expenses incurred and loss provisions provided in connection with other real estate owned.

| | Three Months Ended March 31, | | Increase (Decrease) | |
|---|---|---|---|---|
| | 1992 | 1991 | Amount | Percent |
| | (dollars in thousands) | | | |
| Salaries ard employee benefits.... | $3,271 | $3,347 | $ (76) | (2.3)% |
| Losses on securities commitments.. | 1,375 | - | 1,375 | - |
| Foreclosed properties............. | 1,018 | 204 | 814 | 399.0 |
| Net occupancy..................... | 907 | 951 | (44) | (4.6) |
| Furniture and equipment........... | 543 | 532 | 11 | 2.1 |
| Supply and communication.......... | 396 | 405 | (9) | (2.2) |
| FDIC insurance.................... | 373 | 314 | 59 | 18.8 |
| Business development.............. | 198 | 199 | (1) | (.5) |
| Other............................. | 1,232 | 1,027 | 205 | 20.0 |
| Total Noninterest Expense.... | $9,313 | $6,979 | $2,334 | 33.4 |

The decrease in salaries and employee benefits expense of $76,000 or 2.3% is due to scheduled annual salary adjustments during 1991 offset by decreased group insurance and pension expense and lower staff levels in 1992 compared to 1991. A flexible hiring freeze was imposed in October 1990 whereby normal employee turnover does not lead to automatic replacement, but rather is utilized as an opportunity to restructure positions and reassign responsibilities. This restructuring, together with the consolidation of the remaining major subsidiary Bank support functions at the holding company level during 1991, has reduced staff levels in 1992 compared to 1991. A freeze on all employee scheduled annual salary increases was put into effect in January 1992 and has contributed to the 1992 decreased expense.

For an explanation of the losses on securities commitments of $1,375,000 incurred in the first quarter of 1992, see "Summary" section on pages 11 and 12.

The expenses related to foreclosed properties include provisions for other real estate losses of $705,000 and $93,000 in 1992 and 1991, respectively. For further information, see Note 6 of Notes to Consolidated Financial Statements. The Company anticipates continued high levels of foreclosed property expenses as it continues its property management and foreclosed activities.

Provision for Income Taxes - The provision for income taxes for the three months ended March 31, 1992 and 1991 was $10,000 and $280,000, respectively, representing effective tax rates of .3% in 1992 and 20.6% in 1991. No Federal income tax benefit was recorded during the first quarter of 1992 as a result of deferred debit tax limitations. An extraordinary item was recognized in 1991 in the amount of $270,000 resulting from utilization of a Federal income tax net operating loss carryforward. The Company expenses certain items for financial reporting purposes, principally related to the provision for possible loan losses, which are not currently deductible for tax purposes and result in a deferred tax asset. As of March 31, 1992, the deferred tax asset was approximately $875,000.

Liquidity - The liquidity of a banking institution reflects its ability to provide funds to meet loan requests, to accommodate possible outflows in deposits and to take advantage of interest rate market opportunities. Funding of loan requests, providing for liability outflows, and management of interest rate fluctuations require continuous analysis in order to match the maturities of specific categories of short-term loans and investments with specific types of deposits and borrowings. Bank liquidity is thus normally considered in terms of the nature and mix of a banking institution's sources and uses of funds.

For the Company, the primary sources of liquidity have been loans (including demand loans) and investment securities maturing or repricing within one year, which aggregated approximately $359.4 million as of March 31, 1992. Such sources are supplemented by interest-bearing deposits in other banks and Federal funds sold which amounted to approximately $6.3 million. As of December 31, 1991, loans (including demand loans) and investment securities maturing or repricing within one year were $377.4 million, and Federal funds sold and interest-bearing deposits in other banks amounted to $3.5 million.

The Company had available unused borrowing capacity to provide additional short-term liquidity, primarily in a secured line of credit at the Federal Home Loan bank of Boston, open Federal funds lines and investment securities it could pledge for repurchase agreements.

As of March 31, 1992, the Company had approximately $3.8 million of an unused credit line at the Federal Home Loan Bank of Boston, $14.7 million of open Federal funds lines and $96.0 million of excess investment security collateral for repurchase agreements.

Capital Resources - The Company is subject to capital adequacy guidelines issued by the Federal Reserve Board (the "FRB"). The FRB has approved final risk-based capital guidelines for bank holding companies, such as the Company. When the guidelines are fully phased-in at the end of 1992, the minimum ratio of risk-based capital to risk-adjusted assets (including certain off-balance sheet items such as standby letters of credit) will be 4% and 8% for Tier 1 and Total Capital, respectively. Prior to December 31, 1992, the minimum ratios are 3.625% and 7.25%, respectively. At least half of the total capital is to be comprised of common equity and qualifying perpetual preferred stock, less certain intangible assets ("Tier 1 capital"), although prior to December 31, 1992, Tier 1 capital may include a portion of the reserve for possible loan losses. The remainder ("Tier 2 capital") may consist of mandatory convertible debt securities, qualifying subordinated debt, other preferred stock and a portion of the reserve for possible loan losses.

In addition, the FRB has approved final minimum "leverage" ratio guidelines (Tier 1 capital to total assets, less certain intangible assets) for bank holding companies. These guidelines provide for a minimum leverage ratio of 3% for bank holding companies that meet certain specified criteria. Most bank holding companies (including the Company) are required to maintain a leverage ratio of at least 100 to 200 basis points above the minimum ratio.

The Company's Bank subsidiaries are subject to generally similar capital requirements (including a leverage ratio of at least 100 to 200 basis points above 3%) adopted by the applicable regulatory agencies. As discussed under Note 1 of Notes to Consolidated Financial Statements, Lafayette, in connection with the Agreement entered into with the State in June 1991, is required to increase its Tier 1 leverage capital ratio to 6% by September 16, 1992 and maintain that ratio during the remaining term of the Agreement. Management of Lafayette recognizes that it is unlikely that earnings alone will be sufficient to increase Lafayette's Tier 1 leverage capital ratio to the 6% target by the September 1992 deadline referred to in the Agreement. See Note 1 of Notes to Consolidated Financial Statements for further discussion.

On August 8, 1991 the initial response to the Agreement was filed with the State. This filing contained documents to be provided within 45 days of the signing of the Agreement. The documents filed included (i) Lafayette Bank's Comprehensive Policy for Determining the Adequacy of the Loan Loss Reserve, (ii) the Bank's revised loan policy, (iii) the Bank's Capital Improvement Plan, (iv) the Bank's Profit Plan for improving the earnings of the Bank and (v) the Bank's first progress report as of June 30, 1991 to the Commissioner reflecting actions taken to date to secure the Bank's compliance with the Agreement.

The Bank is required to file quarterly progress reports on the Capital Improvement Plan and Profit Plan within 45 days of each quarter-end. The progress reports as of September 30, 1991 and December 31, 1991 were filed with the State in November 1991 and March 1992, respectively. Each progress report tracks earnings, asset size and nonperforming loan levels compared to the Profit Plan filed.

PART I - FINANCIAL INFORMATION - Continued

In April 1992, the progress report as of March 31, 1992 was filed along with a revised Capital Improvement Plan and Profit Plan reflecting that the 6% Tier 1 leverage capital ratio requirement will probably not be achieved by September 16, 1992. Alternative strategies were submitted for approval to increase Lafayette's leverage capital ratio to the required level within a reasonable period of time.

American, in connection with its proposed Consent Order with the Comptroller, would also be required to increase its Tier 1 leverage capital ratio to a 6% level within 90 days from the date of execution of the document. American intends to attempt to negotiate this time frame in the execution of the final document. See Note 1 of Notes to Consolidated Financial Statements. The Bank has developed and submitted a detailed capital plan to the Comptroller, demonstrating steps contemplated in order to meet regulatory capital requirements in the future.

The Comptroller, during its regular 1991 examination of American, initially contested American reporting its unamortized mortgage servicing rights as an intangible asset the value of which would be includable in regulatory capital. The Comptroller has now advised in writing that if certain changes to this transaction are made, it will allow American to continue to carry the unamortized value of this asset on its books and utilize it in calculating regulatory capital ratios. American intends to make the changes necessary, and the Company has included the unamortized mortgage servicing rights in computing its capital ratios. The risk-based capital ratios as of March 31, 1992 for the Company, American and Lafayette were 7.77%, 7.55% and 7.90%, respectively, and the leverage capital ratios were 4.42%, 4.41% and 4.35%, respectively. If the unamortized mortgage servicing rights intangible asset was deducted from regulatory capital, the risk-based capital ratios for the Company, American and Lafayette would have been 7.03%, 6.20% and 7.90%, respectively, and the leverage capital ratios would have been 3.89%, 3.40% and 4.35%, respectively.

Information regarding the capital ratios of the Company, American and Lafayette as of March 31, 1992, calculated using the transition standards provided in the risk-based capital guidelines and quarter-end asset and capital amounts, are presented below:

|  | As of March 31, 1992 |  |  |
|---|---|---|---|
|  | American | Lafayette | Company |
|  | (dollars in thousands) |  |  |
| Risk-Based Capital |  |  |  |
| Total shareholders' equity.......... | $ 17,262 | $ 15,099 | $ 32,673 |
| Tier 1 capital...................... | 18,988 | 16,609 | 35,940 |
| Total capital....................... | 21,628 | 18,699 | 40,640 |
| Risk-weighted assets................ | 286,403 | 236,785 | 523,284 |
| Tier 1 capital ratio................ | 6.63% | 7.01% | 6.87% |
| Total capital ratio................. | 7.55 | 7.90 | 7.77 |
| Leverage Capital |  |  |  |
| Total shareholders' equity.......... | $ 18,071 | $ 15,399 | $ 33,841 |
| Less certain intangible assets...... | (809) | (300) | (1,168) |
| Total............................... | $ 17,262 | $ 15,099 | $ 32,673 |
| Total assets........................ | $386,224 | $347,045 | $733,422 |
| Add loans sold with recourse........ | 6,207 | - | 6,207 |
| Less certain intangibles............ | (809) | (300) | (1,168) |
| Total............................... | $391,622 | $346,745 | $738,461 |
| Leverage capital ratio.............. | 4.41% | 4.35% | 4.42% |

No dividends were declared by the Board of Directors of the Company for the first quarter of 1992 or 1991. As of March 31, 1992 and 1991, the Company did not have the ability to pay dividends as the result of Federal and state statutory restrictions on the ability of American and Lafayette to pay dividends to the Company.

The Company's success in returning to profitability and achieving adequate regulatory capital ratios will depend largely on its ability to manage successfully current and future levels of nonperforming assets. The Company has projected minimal asset growth and presently anticipates nonperforming assets to continue at the current level during 1992.

PART I - FINANCIAL INFORMATION - Continued

## Consolidated Average Balance Sheets, Net Interest Income and Interest Rates

| | Three Months Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 1992 | | | 1991 | | |
| | Average Balance | Interest | Average Rates(1) | Average Balance | Interest | Average Rates(1) |
| | | | (dollars in thousands) | | | |
| **ASSETS** | | | | | | |
| Interest-earning assets: | | | | | | |
| Interest-bearing deposits with banks | $ 3,176 | $ 34 | 4.31% | $ 4,558 | $ 77 | 6.85% |
| Federal funds sold | 4,825 | 52 | 4.33 | 5,902 | 99 | 6.80 |
| Trading account securities | 364 | 8 | 8.84 | 664 | 14 | 8.55 |
| Investment securities: | | | | | | |
| Taxable | 147,491 | 2,813 | 7.67 | 112,182 | 2,513 | 9.08 |
| Nontaxable | 16,853 | 412 | 9.83 | 34,099 | 861 | 10.24 |
| Loans (net of unearned income) | 506,412 | 11,392 | 9.05 | 535,952 | 14,377 | 10.88 |
| Total interest-earning assets | 679,121 | 14,711 | 8.71 | 693,357 | 17,941 | 10.49 |
| Noninterest-earning assets: | | | | | | |
| Cash and due from banks | 30,255 | | | 29,235 | | |
| Premises and equipment | 7,966 | | | 8,592 | | |
| Other real estate owned, net | 19,541 | | | 18,599 | | |
| Other assets | 19,742 | | | 17,192 | | |
| Reserve for possible loan losses | (15,241) | | | (10,217) | | |
| Total noninterest-earning assets | 62,263 | | | 63,401 | | |
| Total assets | $741,384 | | | $756,758 | | |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| NOW | $ 57,850 | $ 556 | 3.87 | $ 50,422 | 669 | 5.38 |
| Savings | 225,020 | 2,409 | 4.31 | 156,848 | 2,307 | 5.97 |
| Money market | 43,972 | 464 | 4.24 | 29,733 | 411 | 5.61 |
| Time | 235,042 | 3,019 | 5.17 | 338,179 | 6,394 | 7.67 |
| Total interest-bearing deposits | 561,884 | 6,448 | 4.62 | 575,182 | 9,781 | 6.90 |
| Short-term borrowings | 33,318 | 310 | 3.74 | 34,423 | 552 | 6.50 |
| Total interest-bearing liabilities | 595,202 | 6,758 | 4.57 | 609,605 | 10,333 | 6.87 |
| Noninterest-bearing liabilities: | | | | | | |
| Demand deposits | 103,453 | | | 106,737 | | |
| Other liabilities | 5,253 | | | 1,284 | | |
| Total noninterest-bearing liabilities | 108,706 | | | 108,021 | | |
| Shareholders' equity | 37,476 | | | 39,132 | | |
| Total liabilities and shareholders' equity | $741,384 | | | $756,758 | | |
| Net interest income (tax equivalent basis) | | 7,953 | | | 7,608 | |
| Reversal of tax equivalent adjustment | | (145) | | | (313) | |
| Net interest income | | $ 7,808 | | | $ 7,295 | |
| Net interest margin (tax equivalent basis) | | | 4.14% | | | 3.62% |
| Net interest income as a percentage of interest-earning assets (tax equivalent basis) | | | 4.71% | | | 4.45% |

(1) Computed on an annualized basis. Rates are adjusted to a tax equivalent basis using a Federal income tax rate of 34%.

## Consolidated Rate/Volume Analysis(1)

| | First Quarter of 1992 vs. First Quarter of 1991 | | |
|---|---|---|---|
| | Increase (Decrease) Due to Change in | | Total Increase (Decrease) |
| | Average Volume | Average Rate | |
| | (dollars in thousands) | | |
| **Interest Income:** | | | |
| Interest-bearing deposits with banks | $ (19) | $ (24) | $ (43) |
| Federal funds sold | (15) | (32) | (47) |
| Trading account securities | (7) | 1 | (6) |
| Investment securities: | | | |
| Taxable | 715 | (415) | 300 |
| Nontaxable | (426) | (23) | (449) |
| Interest and fees on loans | (631) | (2,354) | (2,985) |
| Total interest income | (383) | (2,847) | (3,230) |
| **Interest Expense:** | | | |
| Interest-bearing deposits: | | | |
| NOW | 94 | (207) | (113) |
| Savings | 843 | (741) | 102 |
| Money market | 167 | (114) | 53 |
| Time | (1,628) | (1,747) | (3,375) |
| Total | (524) | (2,809) | (3,333) |
| Short-term borrowings | (10) | (232) | (242) |
| Total interest expense | (534) | (3,041) | (3,575) |
| Change in net interest income | $ 151 | $ 194 | $ 345 |

(1) This table is presented on a tax equivalent basis.

## PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Neither the Company nor the subsidiary Banks are involved in any legal proceedings other than routine litigation incident to the ordinary course of business of the Company and the Banks, none of which should have a material adverse affect on the Company.

ITEM 2. CHANGES IN SECURITIES

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

A. Exhibits

None.

B. Reports on Form 8-K

No reports on Form 8-K were filed during the first quarter of 1992.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Lafayette American Bancorp, Inc.
(Registrant)

Date: May 13, 1992

Donald P. Calcagnini
Chairman of the Board and
Chief Executive Officer

Date: May 13, 1992

Thomas A. Sebastian
Senior Vice President and
Chief Financial Officer

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

---

FOR QUARTER ENDED MARCH 31, 1992

Commission File No. 0-17120

---

**MEDI-MAIL, INC.**
(Exact name of Registrant as specified in its Charter)

Nevada
(State or other jurisdiction of incorporation or organization)

88-0215949
(I.R.S. Employer Identification No.)

---

101 W. Broadway, Suite 830
San Diego, California 92101

(Address of principal executive offices)

Telephone: (619) 232-2300

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# FORM 10-Q

## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

**[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 1992

**OR**

**[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934**

For the transition period from ______

Commission file number 0-17120

MEDI-MAIL, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Nevada | 88-0215949 |
| State or other jurisdiction of incorporation or organization | (I.R.S. Employer Identification No.) |

101 W. Broadway, Suite 830, San Diego, CA 92101
(Address of principal executive offices) (Zip Code)

(619) 232-2300
(Registrant's telephone number, including area code)

______
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No ____

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class of Stock | Amount Outstanding |
|---|---|
| $.001 par value Common Stock | 8,419,066 Shares outstanding at March 31, 1992 |
| $.001 par value Class B Common Stock | 463,092 Shares outstanding at March 31, 1992 |

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## Medi-Mail, Inc.

### Consolidated Balance Sheet

| | March 31, 1992 (Unaudited) | December 31, 1991 (Unaudited) |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $1,923,564 | $1,525,643 |
| Accounts receivable, less allowance for doubtful accounts and returns of $20,000 at March 31, 1992 and December 31, 1991 | 563,190 | 378,814 |
| Inventories | 714,653 | 453,921 |
| Other current assets | 271,125 | 274,816 |
| | 3,472,532 | 2,633,194 |
| Assets held for sale | 572,706 | 567,706 |
| Property, plant and equipment | 401,001 | 364,047 |
| Other assets | 1,533,896 | 168,562 |
| Total assets | $5,980,135 | $3,733,509 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 452,898 | $ 346,578 |
| Accrued expenses | 48,720 | 15,673 |
| Current portion of long-term debt | 291,579 | 8,241 |
| | 793,197 | 370,492 |
| Long-term debt | 935,333 | 400,000 |
| Common stock: $.001 par value, (20,000,000 shares authorized, 8,419,066 issued and outstanding) | 8,419 | 7,367 |
| Class B common stock: $.001 par value (2,000,000 shares authorized, 463,092 issued and outstanding) | 463 | 846 |
| Notes receivable from stockholders | (5,000) | (5,000) |
| Additional paid-in capital | 8,401,573 | 6,796,409 |
| Accumulated deficit | (4,153,850) | (3,836,605) |
| Stockholders' equity | 4,251,605 | 2,963,017 |
| Total liabilities and stockholders' equity | $5,980,135 | $3,733,509 |

See accompanying notes to financial statements.

## Medi-Mail, Inc.

### Consolidated Statement of Operations

| | For the Three Months Ended March 31, 1992 (Unaudited) | For the Three Months Ended March 31, 1991 (Unaudited) |
|---|---|---|
| **Sales** | $1,794,035 | $1,063,101 |
| **Less:** returns and allowances | 26,744 | 15,711 |
| Net sales | 1,767,291 | 1,047,390 |
| **Less:** Cost of sales | 1,356,666 | 825,191 |
| Gross profit | 410,625 | 222,199 |
| Selling, general and administrative expenses: | | |
| Salaries and benefits | 369,279 | 254,788 |
| Marketing and advertising | 85,022 | 88,525 |
| Other administrative expenses, net of telemarketing reimbursements of $168,166 in 1991 | 268,711 | 33,636 |
| | 723,012 | 376,949 |
| | (312,387) | (154,750) |
| Other income (expense): | | |
| Interest income | 8,103 | |
| Interest expense | (21,448) | (18,523) |
| Rental income | 14,825 | 10,500 |
| Goodwill amortization | (6,709) | |
| Other, net | 370 | 936 |
| | (4,859) | (7,087) |
| Net loss | $ (317,246) | $ (161,837) |
| Net loss per common share | $ (.04) | $ (.03) |
| Weighted average equivalent number of shares | 7,950,189 | 5,141,269 |

See accompanying notes to financial statements.

## Medi-Mail, Inc.

## Consolidated Statement of Cash Flows

| | For the Three Months Ended March 31, | |
|---|---|---|
| | 1992 (Unaudited) | 1991 (Unaudited) |
| Cash flows from (used for) operating activities: | | |
| Cash received from customers | $1,583,285 | $1,033,132 |
| Cash paid to suppliers and employees | (2,045,796) | (1,333,349) |
| Interest (paid) received, net | (13,345) | (18,523) |
| Telemarketing reimbursements | | 168,166 |
| Rental income | 14,825 | 10,500 |
| Net cash used for operating activities | ( 461,031) | (140,074) |
| Cash flows from (used for) investing activities: | | |
| Purchases of property and equipment | ( 13,640) | ( 8,603) |
| Net cash used for investing activities | ( 13,640) | ( 8,603) |
| Cash flows from (used for) financing activities: | | |
| Proceeds from borrowings | | 200,000 |
| Repayment of borrowings | ( 8,241) | (51,623) |
| Proceeds from issuance of warrants for common stock | | 300 |
| Proceeds from issuance of common stock, net | 880,833 | |
| Net cash from financing activities | 872,592 | 148,677 |
| Net increase in cash | 397,921 | -0- |
| Cash balance, beginning of period | 1,525,643 | -0- |
| Cash balance, end of period | $1,923,564 | $ -0- |
| Reconciliation of net loss to net cash used for operating activities: | | |
| Net loss | $ (317,246) | $ (161,837) |
| Adjustments to reconcile net loss to net cash used for operating activities: | | |
| Depreciation and amortization | 43,887 | 13,683 |
| Expenses paid by issuance of common stock | | 4,670 |
| Change in assets and liabilities: | | |
| (Increase) in accounts receivable | (184,376) | (15,194) |
| (Increase) in inventories | ( 36,820) | (19,162) |
| (Increase) decrease in other current assets | 3,691 | 37,547 |
| (Increase) decrease in other assets | (109,534) | (40,124) |
| Increase in accounts payable | 106,320 | 44,932 |
| (Decrease) increase in accrued expenses | 33,047 | ( 4,589) |
| Net cash used for operating activities | $( 461,031) | $ (140,074) |

See accompanying notes to financial statements.

## MEDI-MAIL, INC.

## Notes to Consolidated Financial Statements

### (1) General

Effective February 18, 1992, the Company determined to change its fiscal year end from July 31, to December 31, effective for the fiscal year ended December 31, 1991. The Company previously filed a transition report for the five months ended December 31, 1991. This Form 10-Q is the first calendar quarterly report.

Management has elected to omit substantially all notes to the Company's financial statements. The Company makes reference to the previously filed (i) Form 10-K for the year ended July 31, 1991 as this report incorporates the notes to the Company's year-end financial statements, (ii) Form 10-Q for the transition period from August 1, 1991 through December 31, 1991, (iii) Form 8-K dated January 31, 1992 and (iv) all amendments thereto.

### (2) Unaudited Information

The unaudited condensed consolidated financial statements included herein include the accounts of Medi-Mail, Inc. and its subsidiary (the "Company") and have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. Although the Company believes that the disclosures made in this report are adequate to make the information not misleading, it is suggested that these financial statements be read in connection with the financial statements and notes thereto included in the Company's annual report on Form 10-K for the fiscal year ended July 31, 1991, the Form 8-K dated January 31, 1992 and all amendments thereto and Form 10-Q for the transition period from August 1, 1991 through December 31, 1991.

In the opinion of the Company, the accompanying unaudited financial statements contain all adjustments necessary to present fairly its financial position at March 31, 1992 and December 31, 1991, and the results of operations and its cash flows for the three months ended March 31, 1992 and March 31, 1991.

## (3) Acquisition

On January 31, 1992, the Company completed the acquisition of certain assets of Medco Drugs ("Medco"), a group of retail pharmacies located in and near San Diego, California. The Company acquired operating assets of the four pharmacies, including furniture, fixtures, equipment, inventory, and leasehold improvements, as well as certain intangible assets. The purchase price for the acquisition was $1,551,912. The acquisition was completed by the Company through formation of a wholly owned subsidiary called Medi-Phar, Inc., a Nevada corporation ("Medi-Phar"). Medi-Phar holds all assets acquired in the transaction. Accordingly, the balance sheet of the Company at March 31, 1992 includes the accounts of the Company and its wholly owned subsidiary, Medi-Phar. Operating results of the Medi-Phar pharmacies are included with the operations of the Company commencing February 1, 1992.

The purchase price was satisfied through the issuance of 60,000 registered Common Shares of the Company valued at $375,000 on January 31, 1992, a $350,000 obligation payable subsequent to January 31, 1992 and two promissory notes aggregating $826,912. The acquisition was accounted for as a purchase, whereby the assets acquired were recorded by the Company at their fair market value. The assets' estimated fair market value at the date of the acquisition, are set forth below:

| | |
|---|---|
| Inventory at book value | $ 223,912 |
| Estimated fair market value of fixed assets | 53,000 |
| Value of purchase option | 150,850 |
| Estimated value of non-compete agreement | 117,750 |
| Goodwill (excess of acquisition cost over fair value of net assets acquired) | 1,006,400 |
| Total | $ 1,551,912 |

(This purchase price allocation is subject to adjustment during 1992 for purposes of arriving at the final purchase price allocation.)

The Company's obligation to pay $350,000 to the former owners of Medco was satisfied on February 4, 1992 through issuance of an additional 50,000 registered Common Shares of the Company and the Company's commitment to pay an additional $1,250 to those individuals.

## (4) Capital Stock

During the three month period ended March 31, 1992, an aggregate of 1,025,556 Common Shares of the Company were issued. Of this amount, 382,456 shares represented conversion of Class B Common Stock to Common Stock in accordance with the terms of the Class B Common Stock. Net proceeds aggregating $442,831 were received by the Company in exchange for the issuance of restricted Common Shares and Units pursuant to private placement exemptions from the Federal and certain state securities laws. In addition, the Company issued 363,433 Common Shares pursuant to certain registration statements filed with the Securities and Exchange Commission to officers, directors, employees and consultants of the Company upon exercise of outstanding stock options and warrants. As discussed above, the Company issued 110,000 shares related to the acquisition of the Medco assets. The total increase in Shareholders' equity as a result of these transactions was $1,603,134.

The following table summarizes stock transactions for the Company during the three month period ended March 31, 1992:

| Description of Transaction | Dates | Number of Shares Issued | Subscription Price |
|---|---|---:|---:|
| Class B Conversion | 1/03/92 | 349,180 | |
| Exercise of Stock Options | 1/13/92 | 54,000 | 50,379 |
| Exercise of Warrants | 1/27/92 | 79,714 | 99,042 |
| Acquisition | 1/31/92 | 60,000 | 375,000 |
| Repayment of note | 2/4/92 | 50,000 | 350,000 |
| Class B Conversion | 2/9/92 | 33,276 | |
| Exercise of Stock Options | 2/25/92 | 36,750 | 37,188 |
| Private Placement | 2/6/92 | 169,667 | 442,831 |
| Exercise of Warrants | 2/28/92 | 114,000 | 140,004 |
| Exercise of Warrants | var-March | 78,969 | 108,690 |
| Total | | 1,025,556 | $1,603,134 |

(5) Contingency.

In 1991, the Company issued warrants to acquire 2,000,000 Common Shares to a marketing consultant in connection with services to be rendered to the Company. Of those warrants, 1,750,000 are subject to a vesting schedule contingent on projected sales from contracts originated by the marketing consultant. All of the warrants are exercisable at a price of $3.00 per Common Share. An associated non-cash charge to earnings of the Company could be incurred to the extent the market price of the Company's Common Shares exceeds $3.00 at the time any of these warrants become vested. For further discussion of the potential effect of this contingency, see Management's Discussion and Analysis of Financial Condition and Results of Operations.

# MEDI-MAIL, INC.
## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Liquidity and Capital Resources

During the three month period ended March 31, 1992, the Company's liquidity and working capital increased $416,633 from $2,262,702 at December 31, 1991 to $2,679,335 at March 31, 1992. The increase in working capital resulted from a substantial increase in current assets from December 31, 1991, partially offset by an increase in current liabilities. Cash and cash equivalents increased $397,921 from December 31, 1991, while accounts receivable and inventories increased $184,376 and $260,732, respectively. Current liabilities increased $422,705 from $370,492 at December 31, 1991 to $793,197 at March 31, 1992. The increase in current assets is primarily attributable to the final closing on a private placement completed by the Company during the period, as well as the inventory acquired from Medco. These events also contributed to a substantial increase in total assets, from $3,733,509 at December 31, 1991 to $5,980,135 at March 31, 1992.

Long-term debt increased $535,333 during the period, from $400,000 at December 31, 1991 to $935,333 at March 31, 1992. Current liabilities also increased by $422,705. The increase in long-term debt is associated with the acquisition of Medco assets and is due to the execution of the promissory notes. The increase in current liabilities is partially attributable to a $106,320 increase in accounts payable as well the current portion of long term debt related to the Medco acquisition. The current portion of long-term debt increased as a result of that portion of the Medco notes payable within 12 months. Those notes are payable commencing approximately August 1, 1992 and are payable on a monthly basis as if the notes were amortized over five years, bearing interest at the rate of 8% per annum. The principal amount of the notes may be adjusted downward in the event income from the four Medco pharmacies is less than $372,875 for the twelve-month period commencing January 31, 1992. Following such an adjustment, if any, one-third of the remaining principal balance of the notes will be payable on the first and second anniversaries of closing, with the balance due and payable in full on or before January 31, 1995. Management of the Company anticipates that the operations of Medco, coupled with current financial resources of the Company, will be sufficient to satisfy those promissory notes as they mature.

The remaining portion of long-term debt is attributable to a secured loan on certain real property owned by the Company in the amount of $400,000, which note is due and payable in full on or before October, 1993. Management anticipates selling this real property prior to maturity of that note.

On January 31, 1992, the Company completed the acquisition of assets of Medco Drugs for a purchase price equal to $1,551,912. Consideration delivered by the Company included 60,000 registered Common Shares of the Company valued at $375,000 on January 31, 1992, an obligation to pay an additional $350,000 subsequent to January 31, 1992 and two promissory notes with an aggregate principal amount of $826,912. The $350,000 obligation of the Company was satisfied on February 4, 1992 through the issuance of an additional 50,000 registered Common Shares and an increase in the principal amount of the promissory notes by $1,250. The acquisition was completed by the Company through formation of a wholly owned subsidiary called Medi-Phar, Inc., a Nevada corporation ("Medi-Phar"). Medi-Phar holds all assets acquired in the transaction. Accordingly, the balance sheet of the Company at March 31, 1992 includes the accounts of the Company and its wholly owned subsidiary, Medi-Phar.

In December, 1991, the Company completed the initial closing of a private placement; the final closing of this private placement was completed in February, 1992. The final closing contributed to the increase in working capital and, along with the stock issued related to the Medco acquisition, substantially contributed to the increase in shareholders' equity during the three month period ended March 31, 1992. In December, 1991, an aggregate of 412,000 units of the Company were sold at $3.00 per unit through the efforts of a placement agent retained by the Company. Each unit sold in that offering consisted of one Common Share of the Company and one warrant to acquire an additional Common Share for $5.57 per Share. The final closing of this offering was completed on February 6, 1992 and resulted in additional net proceeds to the Company of $442,831.

Registration of Common Shares of the Company with the Securities and Exchange Commission for issuance pursuant to the exercise of outstanding stock options and warrants in November 1991 resulted in additional proceeds to the Company. During the three month period ended March 31, 1992, an aggregate of 363,433 options and warrants had been exercised for proceeds to the Company of $435,303.

Effective January 10, 1992, the Company registered an aggregate of one million Common Shares for issuance in connection with the acquisition of Medco Drugs, as well as potential future acquisitions. Of that amount, 60,000 Common Shares were issued January 31, 1992 to the former owners of the assets of Medco and 50,000 Common Shares were issued February 4, 1992, both pursuant to the terms of that acquisition. The remaining 860,245 registered Common Shares are available to the Company to be issued in lieu of cash payments for acquisition of securities or assets of other business entities whose business may supplement that of the Company or for acquisition of additional real or personal property to be utilized in the Company's operations. No specific acquisitions are presently contemplated.

The Company also filed an additional registration statement effective April 1, 1992 for registration of additional Common Shares to be issued by the Company upon exercise of outstanding warrants and Common Shares previously issued in a private placement. An aggregate of 2,204,139 Common Shares were registered for current shareholders and issuance to investors in the two private placements conducted by the Company during 1991/1992 upon exercise of outstanding Common Share purchase warrants. Exercise of these outstanding warrants, of which there is no assurance, would result in additional gross proceeds to the Company of approximately $5,356,260.

The Company will be relocating its Las Vegas facility in June, 1992. In connection with the move, the Company anticipates additional monthly rent of $5,300 and relocation costs of approximately $60,000. The Company anticipates that its current capital resources are sufficient to meet these expenditures.

Based upon existing assets of the Company, the acquisition of Medco Drugs and contemplated improvement in operations during calendar 1992, it is anticipated that the Company's liquidity and capital resources will be sufficient for the foreseeable future.

**Results of Operations**

For the three month period ended March 31, 1992, the Company incurred losses of $317,246 on net sales of $1,767,291 and total expenses of $2,084,537. Sales increased $730,934 from the same period a year ago. The sales increase is primarily attributable to Medco. The loss is primarily attributable to an increase in selling, general and administrative expenses. It is anticipated that the Company will continue to incur losses until such time adequate sales volume has been achieved.

Current efforts of the Company are directed at increasing sales and the Company's market share in the retail and mail order pharmacy industry. Management anticipates that this focus on long-term growth rather than immediate profitability will inure to the benefit of the Company and its shareholders. However, this commitment to increase market share will require current investment in the Company's future growth. Accordingly, management is unable to predict at this time when the Company will achieve profitability.

Selling, general and administrative expenses increased from $376,949 for the three month period ended March 31, 1991 to $723,012 for the same period ending in 1992. The increase in salaries and benefits was necessary to obtain and retain qualified personnel to assist in the Company's operations. The increase in other administrative expenses was primarily attributable to marketing costs reimbursements in 1991 which were not reimbursed in 1992. Other administrative expenses also includes approximately $34,000 of non cash charges related to the acquisition of Medco assets.

For the quarter ended March 31, 1992 of which Medco's operations for February and March are included in the Company's operations, Medco contributed sales of $609,649 and net income of $23,483. It is anticipated that Medco serve as a beta test site for future operations of the Company necessary to service acute care medication to complement its mail order service.

The Company has and expects to execute several contracts with third party payor groups which should contribute to increased sales. Sales from contracts executed in its fiscal year ended December 31, 1991 and the first quarter of 1992, together with anticipated sales from these future contracts should commence during the Company's second or third quarter and should contribute to improved operating income. In addition, the Company continues its efforts to negotiate additional contracts.

The Company currently has outstanding 2,000,000 warrants issued to a marketing consultant in connection with services rendered to the Company. Of that amount, 250,000 were vested immediately and the balance are subject to a vesting schedule based on projected sales resulting from contracts obtained through the efforts of this consultant. All warrants will be exercisable to acquire Common Shares of the Company at a price of $3.00 per share. It is anticipated that all or a portion of these contingent warrants may vest in the future based on contracts which may be executed by the Company. Portions of the warrants are scheduled to vest upon execution by the Company of contracts with additional projected revenues of $5 million, $10 million, and $30 million. The Company may execute future contracts through the efforts of this marketing consultant and then must calculate projected sales to the Company. Based on the results of these calculations, a portion of the warrants may become vested.

Under generally accepted accounting principles, the Company will be required to recognize an increase in paid-in capital in an amount equal to a non-cash charge to operations at the time any of the warrants become vested. Such charge will be equal to the difference between the $3.00 exercise price of the warrants and the NASDAQ quoted price of the Company's Common Shares at the time of vesting. The equity section of the Company's financial statements would remain unchanged after this accounting treatment. Based upon current prices for the Company's Common Shares in the over-the-counter market, the Company will be required to recognize a substantial non-cash charge if all of the warrants were to vest presently.

# PART II. OTHER INFORMATION
## MEDI-MAIL, INC.

### ITEM 1. LEGAL PROCEEDINGS.

The Company formally executed a settlement agreement with a former officer, director and employee of the Company resolving their dispute. The terms of the dispute, set forth in a complaint filed in a civil action in the State of Nevada, involved ownership of certain securities of the Company. Pursuant to the terms of the settlement agreement, the Company will receive the proceeds from the sale of approximately 12,000 Common Shares and the balance of the securities will be released to the individual. These proceeds were received in April, 1992.

### ITEM 2. CHANGES IN SECURITIES.

None.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

On January 17, 1992, the Company held its annual meeting of Shareholders. In addition to re-election of the entire Board of Directors and the approval of Price Waterhouse as auditors of the Company for the current fiscal year, the Shareholders approved amendments to the Company's existing stock option plans. An amendment to the Incentive Stock Option Plan increased the number of shares authorized to be issued under that Plan by 300,000 Common Shares. Amendments to the Non-Qualifying Stock Option Plan (NQSOP) instituted a formula pursuant to which each non-employee-director of Company received an automatic grant of 20,000 Common Shares upon completion of one year of service to the Company. The NQSOP was also amended to increase the number of shares authorized to be issued thereunder by 300,000 and otherwise conforming the Plan to certain requirements of Rule 16b-3 under the Securities and Exchange Act of 1934, as amended. Votes cast in favor of amending the ISOP were 2,351,668 and against such amendment were 19,038; votes cast in favor of amending the NQSOP were 3,401,935 and against, 14,038. It is anticipated that the next annual meeting of Shareholders will be held in the Spring of 1993.

### ITEM 5. OTHER INFORMATION.

None.

## ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

**(a) Exhibits.**

Those exhibits previously filed with the Securities and Exchange Commission as required by Item 601 of Regulation S-K, are incorporated herein by reference in accordance with the provisions of Rule 12b-32.

**(b) Reports on Form 8-K.**

(i) Form 8-K dated January 31, 1992, wherein the Company reported the acquisition of Medco Drugs.

(ii) Form 8 dated March 12, 1992 to Form 8-K dated January 31, 1992.

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## SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MEDI-MAIL, INC.

Date: May 13, 1992

By: ______________________________

M.B. Merryman, President and
Principal Executive Officer

AColmie

A.C. Colmie, Principal Financial
Officer

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# FORM 10-Q

**SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**

(Mark One)

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarter Ended March 31, 1992

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

PROCESSED BY
14-3 R
MAY 14 1992

For the transition period from ____________ to ____________

Commission file number 0-5127

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Q-Data Corp. - St. Petersburg, FL
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MERCANTILE BANKSHARES CORPORATION
(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of incorporation or organization)

52-0898572
(I.R.S. Employer Identification No.)

2 Hopkins Plaza, Baltimore, Maryland 21201
(Address of principal executive offices)
(Zip Code)

(410) 237-5900
(Registrant's telephone number, including area code)

______________________________
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes X . No _____.

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

As of April 30, 1992, registrant had outstanding 30,337,606 shares of Common Stock.

BEST COPY
AVAILABLE

## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements

(a) Published Financial Statements, as required by Rule 10-01 of Regulation S-X, are set forth on pages 4 thru 7 of Exhibit 20, attached hereto and incorporated herein.

Note - Commitments:

Various commitments to extend credit (lines of credit) are made in the normal course of banking business. At March 31, 1992, total unused lines of credit approximated $1,322,224,200. In addition, letters of credit are issued for the benefit of customers by affiliated banks. Outstanding letters of credit were $91,664,100 at March 31, 1992.

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

(a) Management's Discussion and Analysis of Financial Condition and Results of Operations as required by Item 303 of Regulation S-K is included on page 8 of Exhibit 20, attached hereto and incorporated herein.

## PART II. OTHER INFORMATION

### Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits -
Exhibit 20 - Financial Information. See Part I

(b) No forms 8-K filed.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**MERCANTILE BANKSHARES CORPORATION**

BY____________________
H. Furlong Baldwin
Chairman of the Board

BY Charles C McGuire Jr
Charles C. McGuire, Jr.
Sr. Vice President and Treasurer

# MERCANTILE BANKSHARES CORPORATION

EXHIBIT 20

**To Our Shareholders:**

Net income for the first quarter of 1992 was $.62 per share, the same as for the first quarter of 1991. Consolidated net income for the first three months of 1992 was $18,871,000 compared to $18,545,000 for 1991.

At March 31, 1992, total assets were $5,207,723,000, an increase of 7% over the $4,888,098,000 at March 31, 1991 and total stockholders' equity was $555,910,000, an increase of 10% over the comparable amount last year. For more detailed analyses of quarterly results, please see Management's Discussion on page 8.

Certain key ratios measure earnings and financial strength. The annualized return on average total assets was 1.5% and the annualized return on average equity was 13.8% for the quarter. Average equity to average total assets was 10.8%. The allowance for loan losses was 2.0% of total loans at the end of the quarter.

H. Furlong Baldwin
Chairman of the Board

Two Hopkins Plaza/P.O. Box 1477/Baltimore, Maryland 21203/(410)237-5900

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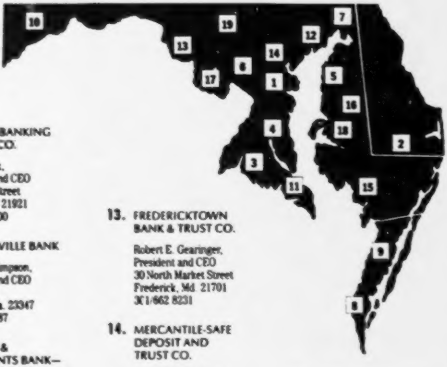
## PRINCIPAL AFFILIATES



1. **THE ANNAPOLIS BANKING AND TRUST CO.**

Robert E. Henel, Jr.,
President and CEO
Main Street & Church Circle
Annapolis, Md. 21401
410/268-3366

2. **BALTIMORE TRUST CO.**

Robert E. Dickerson,
President and CEO
One West Church Street
Selbyville, De. 19975
302/436-8236

3. **BANK OF SOUTHERN MARYLAND**

Wesley E. Hughes, Jr.,
President and CEO
304 Charles Street
LaPlata, Md. 20646
301/934-1000

4. **CALVERT BANK AND TRUST CO.**

Harold J. Kahl,
Chairman, President and CEO
Calvert Village
Shopping Center
Prince Frederick, Md.
20678
410/535-3535

5. **THE CHESTERTOWN BANK OF MARYLAND**

R. Raymond Tarrach,
President and CEO
211 High Street
Chestertown, Md. 21620
410/778-2400

6. **THE CITIZENS NATIONAL BANK**

Martin A. Sharpless,
President and CEO
Fourth & Main Streets
Laurel, Md. 20707
301/725-3100

7. **COUNTY BANKING & TRUST CO.**

S. Dell Foxx,
President and CEO
123 North Street
Elkton, Md. 21921
410/398-2800

8. **THE EASTVILLE BANK**

Robert L. Simpson,
President and CEO
P.O. Box 7
Eastville, Va. 23347
804/678-5187

9. **FARMERS & MERCHANTS BANK—EASTERN SHORE**

H. B. Rew, Jr.,
President and CEO
25253 Lankford Highway
Onley, Va. 23418
804/787-4111

10. **THE FIDELITY BANK**

C. Joseph Cunningham, III,
President and CEO
59 East Main Street
Frostburg, Md. 21532
301/689-1111

11. **THE FIRST NATIONAL BANK OF ST. MARY'S**

Joseph M. Gough, Jr.,
Chairman and CEO
5 East Park Avenue
Leonardtown, Md.
20650
301/475-8081

12. **THE FOREST HILL STATE BANK**

Paul E. Peak,
President and CEO
130 South Bond Street
Bel Air, Md. 21014
410/838-6131

13. **FREDERICKTOWN BANK & TRUST CO.**

Robert E. Gearinger,
President and CEO
30 North Market Street
Frederick, Md. 21701
301/662 8231

14. **MERCANTILE-SAFE DEPOSIT AND TRUST CO.**

H. Furlong Baldwin,
Chairman and CEO
2 Hopkins Plaza
Baltimore, Md. 21201
410/237 5900

15. **PENINSULA BANK**

Hugh W. Mohler,
President and CEO
11738 Somerset
Avenue
Princess Anne, Md.
21853
410/651 2400

16. **THE PEOPLES BANK OF MARYLAND**

Jeffrey N. Heflebower,
President and CEO
205 Market Street
Denton, Md. 21629
410/479 2600

17. **POTOMAC VALLEY BANK**

R. Dennis Homberg,
President and CEO
702 Russell Avenue
Gaithersburg, Md.
20877
301/963 7600

18. **ST. MICHAELS BANK**

William W. Duncan, Jr.,
President and CEO
213 Talbot Street
St. Michaels, Md. 21663
410/745-5091

19. **WESTMINSTER BANK AND TRUST CO.**

Ferdinand A. Ruppel, Jr.,
President and CEO
71 East Main Street
Westminster, Md. 21157
410/848 9300

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**MERCANTILE MORTGAGE CORPORATION**

Paul W. Parks,
President and CEO
200 East Redwood
Street
Baltimore, Md. 21202
410/347 8940

## CONSOLIDATED FINANCIAL SUMMARY

| *(Dollars in thousands, except per share data)* | *For the 3 Months Ended March 31,* 1992 | 1991 | % In ase (De ase) |
|---|---|---|---|
| **OPERATING RESULTS** | | | |
| Net interest income | **$53,216** | $50,539 | 5% |
| Net interest income—taxable equivalent | **54,188** | 51,996 | 4 |
| Provision for loan losses | **1,943** | 1,587 | 22 |
| Net income | **18,871** | 18,545 | 2 |
| **PER COMMON SHARE DATA** | | | |
| Net income | **$ .62** | $ .62 | |
| Dividends paid | **.21½** | .21½ | |
| Book value at period end | **18.34** | 16.81 | 9% |
| Market value at period end | **28¾** | 24¾ | 16 |
| Market range: | | | |
| High | **28¾** | 25½ | 13 |
| Low | **25½** | 18¼ | 40 |
| **AVERAGE CONSOLIDATED BALANCE SHEETS** | | | |
| Total loans | **$3,360,300** | $3,291,200 | 2% |
| Total earning assets | **4,800,100** | 4,547,900 | 6 |
| Total assets | **5,089,600** | 4,822,600 | 6 |
| Total deposits | **4,191,700** | 3,951,900 | 6 |
| Stockholders' equity | **551,400** | 499,200 | 10 |
| **RATIOS** (Net income annualized) | | | |
| Return on average assets | **1.49%** | 1.56% | (4)% |
| Return on average equity | **13.76** | 15.07 | (9) |
| Average equity to average assets | **10.83** | 10.35 | 5 |
| Net interest rate spread—taxable equivalent | **3.52** | 3.31 | 6 |
| Effect of noninterest-bearing funds—taxable equivalent | **1.02** | 1.33 | (23) |
| Net interest margin on earning assets—taxable equivalent | **4.54** | 4.64 | (2) |
| Provision for loan losses (annualized) to period end loans | **.23** | .19 | 21 |
| Net charge-offs (annualized) to period end loans | **.18** | .26 | (31) |
| Non-performing loans to period end loans | **1.86** | 1.40 | 33 |
| Allowance for loan losses to period end loans | **1.95** | 1.63 | 20 |
| Allowance for loan losses to non-performing loans | **104.85** | 116.62 | (10) |
| Other real estate owned to period end loans and OREO | **.76** | .22 | 245 |
| Non-performing assets to period end loans and OREO | **2.61** | 1.61 | 62 |

See notes to consolidated financial statements

## CONSOLIDATED BALANCE SHEETS

| *(Dollars in thousands, except per share data)* | ***March 31,*** **1992** | *December 31,* 1991 |
|---|---|---|
| **ASSETS** | | |
| Cash and due from banks | **$ 213,704** | $ 201,037 |
| Interest-bearing deposits in other banks | **850** | 1,350 |
| Investment securities—market value of $1,462,487 (1992) and $1,394,298 (1991) | | |
| U.S. Treasury and government agencies | **1,419,914** | 1,331,406 |
| States and political subdivisions | **7,872** | 8,845 |
| Other investments | **4,578** | 4,835 |
| Total investment securities | **1,432,364** | 1,345,086 |
| Federal funds sold | **50,175** | 60,525 |
| Securities purchased under resale agreements | | 80,000 |
| Loans | **3,394,723** | 3,374,937 |
| Less: allowance for loan losses | **(66,344)** | (65,932) |
| Loans, net | **3,328,379** | 3,309,005 |
| Bank premises and equipment, less accumulated depreciation of $50,317 (1992) and $50,111 (1991) | **64,485** | 64,173 |
| Other real estate owned | **25,911** | 27,116 |
| Excess cost over equity in affiliated banks, net | **21,971** | 22,254 |
| Other assets | **69,884** | 72,310 |
| Total assets | **$5,207,723** | $5,182,856 |
| **LIABILITIES** | | |
| Deposits: | | |
| Noninterest-bearing deposits | **$ 776,105** | $ 801,562 |
| Interest-bearing deposits | **3,514,701** | 3,472,334 |
| Total deposits | **4,290,806** | 4,273,896 |
| Short-term borrowings | **320,949** | 331,809 |
| Accrued expenses and other liabilities | **24,306** | 18,443 |
| Long-term debt | **15,752** | 16,609 |
| Total liabilities | **4,651,813** | 4,640,757 |
| **STOCKHOLDERS' EQUITY** | | |
| Preferred stock, no par value; authorized 2,000,000 shares; issued and outstanding—None | | |
| Common stock, $2 par value; authorized 67,000,000 shares; issued 30,315,217 shares in 1992 and 30,249,328 shares in 1991 | **60,630** | 60,499 |
| Capital surplus | **52,126** | 50,803 |
| Retained earnings | **443,154** | 430,797 |
| Total stockholders' equity | **555,910** | 542,099 |
| Total liabilities and stockholders' equity | **$5,207,723** | $5,182,856 |

See notes to consolidated financial statements

# STATEMENT OF CONSOLIDATED INCOME

| *(Dollars in thousands, except per share data)* | *For the 3 Months Ended March 31,* 1992 | 1991 |
|---|---|---|
| **INTEREST INCOME** | | |
| Interest and fees on loans | $75,580 | $84,582 |
| Interest and dividends on investment securities: | | |
| Taxable interest income | 24,038 | 20,262 |
| Tax-exempt interest income | 139 | 246 |
| Dividends | 67 | 61 |
| Other investment income | 15 | 32 |
| | 24,259 | 20,601 |
| Other interest income | 712 | 4,170 |
| Total interest income | 100,551 | 109,353 |
| **INTEREST EXPENSE** | | |
| Interest on deposits | 44,150 | 53,794 |
| Interest on short-term borrowings | 2,878 | 4,691 |
| Interest on long-term debt | 307 | 329 |
| Total interest expense | 47,335 | 58,814 |
| **NET INTEREST INCOME** | 53,216 | 50,539 |
| Provision for loan losses | 1,943 | 1,587 |
| **NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES** | 51,273 | 48,952 |
| **NONINTEREST INCOME** | | |
| Trust division services | 9,407 | 8,759 |
| Rental income | 1,765 | 1,809 |
| Service charges on deposit accounts | 3,678 | 2,937 |
| Other fees and commissions | 4,143 | 3,162 |
| Investment securities gains | 200 | |
| Other income | 467 | 352 |
| Total noninterest income | 19,660 | 17,019 |
| **NONINTEREST EXPENSES** | | |
| Salaries | 18,699 | 17,173 |
| Employee benefits | 5,146 | 4,255 |
| Net occupancy expense of bank premises | 3,601 | 3,538 |
| Furniture and equipment expenses | 2,935 | 2,789 |
| Communications and supplies | 2,152 | 2,054 |
| FDIC insurance premium expense | 2,457 | 2,063 |
| Other expenses | 5,678 | 4,771 |
| Total noninterest expenses | 40,668 | 36,643 |
| Income before income taxes | 30,265 | 29,328 |
| Applicable income taxes | 11,394 | 10,783 |
| **NET INCOME** | $18,871 | $18,545 |
| **NET INCOME PER SHARE OF COMMON STOCK** *(2)* | $.62 | $.62 |

See notes to consolidated financial statements

## STATEMENT OF CONSOLIDATED CASH FLOWS

| *Decrease in cash and cash equivalents*<br>*(Dollars in thousands)* | *For the 3 Months Ended March 31,*<br>**1992** | <br>1991 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | |
| Interest and fees on loans | **$ 77,266** | $ 86,374 |
| Interest and dividends on investment securities | **21,373** | 18,110 |
| Other interest income | **794** | 5,016 |
| Noninterest income | **19,116** | 16,730 |
| Interest paid | **(49,209)** | (59,159) |
| Noninterest expenses | **(30,949)** | (31,397) |
| Income taxes paid | **(6,643)** | (7,935) |
| Net cash provided by operating activities | **31,748** | 27,739 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | |
| Proceeds from sales of investment securities | **217** | |
| Proceeds from maturities of investment securities | **72,864** | 86,937 |
| Purchase of investment securities | **(160,159)** | (182,352) |
| Net increase in customer loans | **(21,136)** | (9,364) |
| Capital expenditures | **(1,850)** | (1,480) |
| Net cash used in investing activities | **(110,064)** | (106,259) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | |
| Net decrease in noninterest-bearing deposits | **(25,457)** | (66,016) |
| Net increase in NOW and savings accounts | **138,757** | 110,049 |
| Net increase (decrease) in certificates of deposit | **(96,390)** | 9,187 |
| Net decrease in short-term borrowings | **(10,860)** | (71,647) |
| Repayment of long-term debt | **(857)** | (195) |
| Proceeds from issuance of shares | **1,454** | 7,151 |
| Dividends paid | **(6,514)** | (6,467) |
| Net cash provided by (used in) financing activities | **133** | (17,938) |
| Net decrease in cash and cash equivalents | **(78,183)** | (96,458) |
| Cash and cash equivalents at beginning of period | **342,912** | 516,641 |
| Cash and cash equivalents at end of period | **$264,729** | $420,183 |

| *Reconciliation of net income to net cash provided by operating activities*<br>*(Dollars in thousands)* | *For the 3 Months Ended March 31,*<br>**1992** | <br>1991 |
|---|---|---|
| Net income | **$18,871** | $18,545 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | **1,612** | 1,585 |
| Provision for loan losses | **1,943** | 1,587 |
| Write-down of other real estate owned | **1,024** | |
| Investment securities (gains) | **(200)** | |
| Amortization of excess cost over equity in affiliates | **283** | 283 |
| Increase in taxes payable | **4,751** | 2,848 |
| (Increase) decrease in interest receivable | **(1,118)** | 147 |
| Increase in other receivables | **(344)** | (289) |
| Decrease in other assets | **3,814** | 4,070 |
| Decrease in interest payable | **(1,874)** | (345) |
| Increase (decrease) in accrued expenses | **2,986** | (692) |
| Total adjustments | **12,877** | 9,194 |
| Net cash provided by operating activities | **$31,748** | $27,739 |

See notes to consolidated financial statements

## STATEMENT OF CHANGES IN CONSOLIDATED STOCKHOLDERS' EQUITY

**FOR THE THREE MONTHS ENDED MARCH 31, 1992 AND 1991**

| *(Dollars in thousands, except per share data)* | Common Stock | Capital Surplus | Retained Earnings |
|---|---|---|---|
| BALANCE, DECEMBER 31, 1990 | $59,429 | $41,011 | $386,171 |
| Net income | | | 18,545 |
| Cash dividends paid: | | | |
| Common stock ($.21½ per share) | | | (6,467) |
| Issuance of 15,239 shares for dividend reinvestment and stock purchase plan | 31 | 333 | |
| Issuance of 3,583 shares for employee stock purchase dividend reinvestment plan | 7 | 70 | |
| Issuance of 360,712 shares for employee stock option plan | 721 | 5,9[illegible] | |
| BALANCE, MARCH 31, 1991 | $60,188 | $47,403 | $398,249 |
| BALANCE, DECEMBER 31, 1991 | $60,499 | $50,803 | $430,797 |
| Net income | | | 18,871 |
| Cash dividends paid: | | | |
| Common stock ($.21½ per share) | | | (6,514) |
| Issuance of 16,436 shares for dividend reinvestment and stock purchase plan | 33 | 419 | |
| Issuance of 2,833 shares for employee stock purchase dividend reinvestment plan | 5 | 70 | |
| Issuance of 46,620 shares for employee stock option plan | 93 | 834 | |
| **BALANCE, MARCH 31, 1992** | **$60,630** | **$52,126** | **$443,154** |

**NOTES**

1) The statements include the accounts of the Corporation and all of its affiliates, with all significant intercompany transactions eliminated, and in the opinion of management, include all adjustments necessary for a fair presentation of the results for the interim period. All such adjustments are of a normal recurring nature. In view of the changing conditions in the national economy, the effect of actions taken by regulatory authorities and normal seasonal factors, the results for the interim period are not necessarily indicative of annual performance.

2) Per share amounts are based on the weighted average number of common shares outstanding during the period or 30,289,160 shares for 1992 and 29,964,302 shares for 1991.

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Net income for the first quarter of 1992 was $.62 per share, the same as the first quarter of 1991. Per share amounts are based on the weighted average number of common shares outstanding of 30,289,160 for 1992 and 29,964,302 for 1991.

Net interest income for the first three months of 1992 was 5% higher than the amount for the comparable period in 1991 due to higher volumes of earning assets and to greater declines in interest paid than in interest earned. Total noninterest income increased by 16% while total noninterest expenses, excluding the provision for loan losses, for the first quarter of 1992 increased 11% over the comparable period in 1991.

The provision for loan losses for the first quarter of 1992 was $1,943,000 compared to $1,587,000 in the first quarter of 1991. The allowance for loan losses at March 31, 1992 was $66,344,000 or 1.95% of total loans outstanding. This compares with $53,972,000 or 1.63% at March 31, 1991 and $65,932,000 or 1.95% at December 31, 1991. Net charge-offs were $1,531,000 for the first quarter of 1992 and $2,086,000 for the comparable quarter in 1991. Non-performing loans totalled $63,278,000 or 1.86% of total loans at March 31, 1992 as compared to $46,282,000 or 1.40% as of March 31, 1991 and $59,627,000 or 1.77% of total loans as of December 31, 1991. Other real estate owned amounted to $25,911,000 at March 31, 1992 compared to $7,296,000 as of March 31, 1991 and $27,116,000 at December 31, 1991.

Average total deposits for the first three months were $4,191,700,000, up 6% over $3,951,900,000 for the comparable period in 1991. Average total loans for the first three months of 1992 were $3,360,300,000 which was 2% higher than in 1991.

## ANALYSIS OF INTEREST RATES AND INTEREST DIFFERENTIALS

The following table presents the distribution of the average consolidated balance sheets, interest income/expense and annualized yields earned and rates paid through the first three months of the year.

| | 1992 | | | 1991 | | |
|---|---|---|---|---|---|---|
| *(Dollars in thousands)* | Average Balance | Income*/ Expense | Yield*/ Rate | Average Balance | Income*/ Expense | Yield*/ Rate |
| Earning assets | | | | | | |
| Loans: | | | | | | |
| Commercial | $1,012,200 | $ 20,539 | 8.2% | $1,017,000 | $ 24,956 | 10.0% |
| Mortgage and construction | 1,560,600 | 36,590 | 9.4 | 1,446,400 | 37,711 | 10.6 |
| Consumer | 787,500 | 19,319 | 9.9 | 827,800 | 23,211 | 11.4 |
| Total loans | 3,360,300 | 76,448 | 9.2 | 3,291,200 | 85,878 | 10.6 |
| Federal funds sold | 56,800 | 615 | 4.4 | 45,800 | 723 | 6.4 |
| Securities purchased under resale agreements | 6,400 | 77 | 4.8 | 209,400 | 3,392 | 6.6 |
| Securities: | | | | | | |
| Taxable securities | | | | | | |
| U.S. Treasury securities | 1,356,200 | 23,900 | 7.1 | 962,300 | 19,905 | 8.4 |
| U.S. Agency and other securities | 6,500 | 138 | 8.5 | 17,000 | 357 | 8.5 |
| Other stocks and bonds | 4,700 | 109 | 9.3 | 5,700 | 117 | 8.3 |
| Tax-exempt securities | | | | | | |
| States and political subdivisions | 8,300 | 216 | 10.5 | 13,900 | 383 | 11.2 |
| Total securities | 1,375,700 | 24,363 | 7.1 | 998,900 | 20,762 | 8.4 |
| Interest-bearing deposits in other banks | 900 | 20 | 8.9 | 2,600 | 55 | 8.6 |
| Total earning assets | 4,800,100 | 101,523 | 8.5 | 4,547,900 | 110,810 | 9.9 |
| Cash and due from banks | 175,900 | | | 172,300 | | |
| Bank premises and equipment, net | 64,500 | | | 63,000 | | |
| Other assets | 115,800 | | | 94,700 | | |
| Less: allowance for loan losses | (66,700) | | | (55,300) | | |
| Total assets | $5,089,600 | | | $4,822,600 | | |
| Interest-bearing liabilities | | | | | | |
| Deposits: | | | | | | |
| Savings deposits | $1,830,200 | 19,351 | 4.3 | $1,412,600 | 18,518 | 5.3 |
| Time deposits | 1,662,700 | 24,799 | 6.0 | 1,882,200 | 35,276 | 7.6 |
| Total interest-bearing deposits | 3,492,900 | 44,150 | 5.1 | 3,294,800 | 53,794 | 6.6 |
| Short-term borrowings | 305,800 | 2,878 | 3.8 | 317,700 | 4,691 | 6.0 |
| Long-term debt | 15,900 | 307 | 7.8 | 17,200 | 329 | 7.8 |
| Total interest-bearing funds | 3,814,600 | 47,335 | 5.0 | 3,629,700 | 58,814 | 6.6 |
| Noninterest-bearing deposits | 698,800 | | | 657,100 | | |
| Other liabilities and accrued expenses | 24,800 | | | 36,600 | | |
| Total liabilities | 4,538,200 | | | 4,323,400 | | |
| Stockholders' equity | 551,400 | | | 499,200 | | |
| Total liabilities and stockholders' equity | $5,089,600 | | | $4,822,600 | | |
| Net interest income | | $ 54,188 | | | $ 51,996 | |
| Net interest rate spread | | | 3.5% | | | 3.3% |
| Effect of noninterest-bearing funds | | | 1.0 | | | 1.3 |
| Net interest margin on earning assets | | | 4.5% | | | 4.6% |
| Taxable-equivalent adjustment included in: | | | | | | |
| Loan income | | $ 868 | | | $ 1,296 | |
| Investment securities income | | 104 | | | 161 | |
| Total | | $ 972 | | | $ 1,457 | |

*Presented on a tax equivalent basis using the statutory federal corporate income tax rate of 34%.

## MERCANTILE BANKSHARES CORPORATION

### EXECUTIVE OFFICERS

H. Furlong Baldwin
*Chairman of the Board and Chief Executive Officer*

Douglas W. Dodge
*Vice Chairman of the Board*

Edward K. Dunn, Jr.
*President*

Kenneth A. Bourne, Jr.
*Executive Vice President*

Charles C. McGuire, Jr.
*Senior Vice President and Treasurer*

John A. O'Connor, Jr.
*Senior Vice President and Secretary*

Robert W. Johnson
*Senior Vice President*

O. James Talbott, II
*Senior Vice President*

Brian B. Topping
*Vice President*

### DIRECTORS

H. Furlong Baldwin
*Chairman of the Board and Chief Executive Officer of Mercantile Bankshares Corporation and Chairman of the Board and Chief Executive Officer of Mercantile-Safe Deposit and Trust Company*

Thomas M. Bancroft, Jr.
*Former Chairman of the Board and Chief Executive Officer of The New York Racing Association*

Richard O. Berndt
*Partner in law firm of Gallagher, Evelius & Jones*

Douglas W. Dodge
*Vice Chairman of the Board of Mercantile Bankshares Corporation and President and Chief Operating Officer of Mercantile-Safe Deposit and Trust Company*

Edward K. Dunn, Jr.
*President of Mercantile Bankshares Corporation and a Vice Chairman of the Board of Mercantile-Safe Deposit and Trust Company*

B. Larry Jenkins
*Chairman of the Board, President and Chief Executive Officer of Monumental Life Insurance Company and a Vice President of Aegon USA, Inc.*

Robert D. Kunisch
*Chairman of the Board, President and Chief Executive Officer of PHH Corporation*

William J. McCarthy
*Principal of William J. McCarthy, P.C., a Partner in the law firm of Venable, Baetjer and Howard*

Morris W. Offit
*Chairman of the Board and Chief Executive Officer of OFFITBANK*

James M. O'Neill
*Former General Manager, Baltimore Works, AT&T Technologies, Co., Inc.*

Christian H. Poindexter
*Vice Chairman of the Board of Baltimore Gas & Electric Company*

William B. Potter
*Chairman of the Board, President and Chief Executive Officer of Preston Corporation*

William C. Richardson
*President of The Johns Hopkins University*

Bishop L. Robinson
*Secretary of the Department of Public Safety and Correctional Services for the State of Maryland*

Brian B. Topping
*Vice President of Mercantile Bankshares Corporation and a Vice Chairman of the Board of Mercantile-Safe Deposit and Trust Company*

Jay M. Wilson
*President of Steeltin Can Corporation and related companies*

Calman J. Zamoiski, Jr
*President of Independent Distributors, Incorporated*

## CORPORATE INFORMATION

### STRUCTURE/STRATEGY

Mercantile Bankshares Corporation is a multi-bank holding company with nineteen affiliate banks and a mortgage banking company. Each member bank operates as a community bank, with its own name, management, Board of Directors, and tradition of community service.

While operating as a community bank, with a high degree of local autonomy and community identification, each affiliate is able to offer the more sophisticated services and outstanding financial strength of a major banking organization.

Our announced policy, across the affiliate system, is to establish ongoing customer relationships founded on service, and to focus on those particular services we know how to perform well.

### PERSONAL BANKING

The banking affiliates of Mercantile Bankshares Corporation have 142 retail banking offices providing personal banking services. Services include deposit vehicles such as checking accounts, NOW accounts, Money Market Deposit Accounts, Certificates of Deposit, and Individual Retirement Accounts. Loans are made to individuals to meet a variety of consumer needs.

### CORPORATE BANKING

Each of the Corporation's affiliates pursues a commercial banking program serving local businesses. The primary corporate banking effort for medium and large companies is centered at Mercantile-Safe Deposit and Trust Company. Corporate banking services include the making of various types of commercial and real estate loans, accepting deposits, cash management and short-term money market investing.

### TRUST AND INVESTMENT

The Trust Division of Mercantile-Safe Deposit and Trust Company provides services to individuals, corporations and non-profit institutions. Services for individuals include investment management, estate settlement, living and testamentary trusts and custody of securities. Employee benefit plans, master and directed trusteeship and corporate financial services are provided to businesses. Endowment trusts are managed for non-profit institutions. The Trust Division is also investment advisor to M.S.D.&T. Funds, Inc., which provides a series of open-ended, no-load mutual funds available to clients of the Trust Division.

### MORTGAGE BANKING

Through offices in Maryland and Delaware, Mercantile Mortgage Corporation generates and services real estate mortgage loans and construction loans, as principal and as agent. Residential and commercial real estate appraisals are offered through an appraisal subsidiary.

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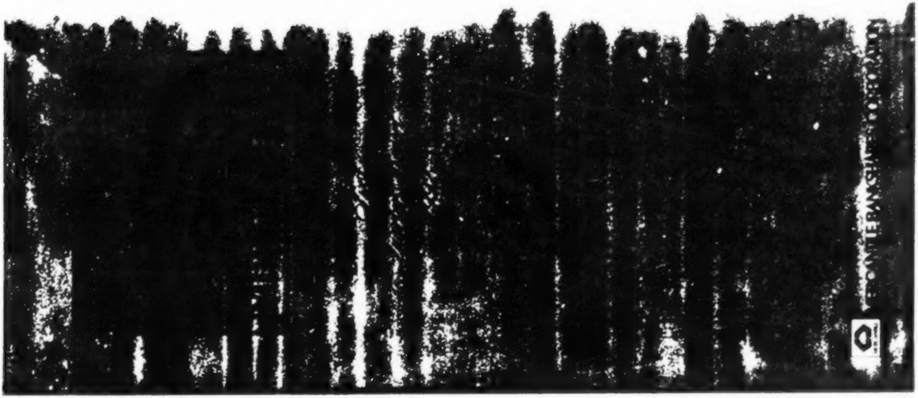
### AUTOMATIC DIVIDEND REINVESTMENT AND STOCK PURCHASE PLAN:

Mercantile Bankshares Corporation offers its shareholders of common stock a Plan whereby they may automatically invest their cash dividends in Mercantile stock at a price which is 5% less than the market price on the dividend payment date. Plan participants may also make additional cash payments to purchase stock through the Plan at the market price. Mercantile Bankshares Corporation absorbs all fees and transaction costs.

Shareholders who wish to enroll in the Plan should contact the Corporation's Transfer Agent.

### DIVIDEND DISBURSING AGENT AND TRANSFER AGENT FOR STOCK:

Mercantile-Safe Deposit and Trust Company
Corporate Trust Department
2 Hopkins Plaza, P.O. Box 2258
Baltimore, Maryland 21203
(410) 237-5211



MERCANTILE BANKSHARES
CORPORATION

2 Hopkins Plaza
P.O. Box 1477
Baltimore, Maryland 21203

PRESORTED
FIRST CLASS MAIL
U.S. POSTAGE PAID
BALTIMORE, MD
PERMIT NO. 2210

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# FORM 10-Q

# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**[ X ] QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 1992**

**OR**

**[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from ____________________ to ______________**

**BEST COPY AVAILABLE**

**Commission File No. 33-42783**

## NATIONAL REHABILITATION CENTERS, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **TENNESSEE** | **62-1240654** |
| (State or other Jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**200 Powell Place**
**Suite 210**
**Brentwood, Tennessee 37027**
(Mailing Address)

**200 Powell Place, Suite 210, Brentwood, TN 37027**
(Address of principal executive offices)
(ZIP code)

**(615) 377-2937**
(Registrant's telephone number including Area Code)

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MAY 18 1992

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Q-Data Corp. - St. Petersburg, FL

L36

**Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.**
**Yes __X__ No ______**

**Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the latest practicable date.**

**As of April 30, 1992 there were 3,798,579 shares of National Rehabilitation Centers, Inc. common stock outstanding.**

# NATIONAL REHABILITATION CENTERS, INC.

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## NATIONAL REHABILITATION CENTERS, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

| | Three Months Ended March 31, | |
|---|---|---|
| | 1992 | 1991 |
| NET PATIENT SERVICE REVENUE (includes management fee from affiliate of $–0–, and $65,375, respectively) | $ 8,003,536 | $ 4,911,478 |
| OPERATING EXPENSES: | | |
| Payroll and benefits | 3,810,638 | 2,140,851 |
| Contract services | 1,388,705 | 885,737 |
| Rent expense | 417,204 | 292,597 |
| Other direct operating expenses | 1,124,183 | 717,284 |
| Provision for uncollectible accounts | 415,930 | 304,717 |
| Depreciation and amortization | 215,771 | 176,231 |
| Total operating expenses | 7,372,431 | 4,517,417 |
| EARNINGS FROM OPERATIONS | 631,105 | 394,061 |
| OTHER (INCOME) EXPENSES: | | |
| Interest expense | 74,065 | 92,263 |
| Interest income | (138,247) | (22,481) |
| Other, net | (65,046) | (41,727) |
| EARNINGS BEFORE INCOME TAXES AND EXTRAORDINARY ITEM | 760,333 | 366,006 |
| INCOME TAXES | 296,500 | 157,383 |
| EARNINGS BEFORE EXTRAORDINARY ITEM | 463,833 | 208,623 |
| EXTRAORDINARY ITEM, | | |
| Utilization of net operating loss carryforward | – | 71,137 |
| NET EARNINGS | $ 463,833 | $ 279,760 |
| EARNINGS PER COMMON AND COMMON EQUIVALENT SHARE: | | |
| Before extraordinary item | $ 0.12 | $ 0.09 |
| Extraordinary item | 0.00 | 0.03 |
| Net earnings | $ 0.12 | $ 0.12 |
| WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING | 3,951,017 | 2,332,182 |

See notes to consolidated financial statements.

## NATIONAL REHABILITATION CENTERS, INC.

## CONSOLIDATED BALANCE SHEETS

| | March 31, 1992 | December 31, 1991 (1) |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 15,909,627 | $ 18,537,004 |
| Accounts receivable, less allowance for doubtful accounts and contractual allowances of approximately $3,441,000 and $2,245,000, respectively | 5,143,520 | 4,128,543 |
| Deferred taxes | 148,500 | 161,000 |
| Prepaids and other current assets | 393,251 | 247,069 |
| TOTAL CURRENT ASSETS | 21,594,898 | 23,073,616 |
| PROPERTY AND EQUIPMENT, net | 4,157,124 | 3,614,054 |
| EXCESS OF COST OVER FAIR VALUE OF NET ASSETS ACQUIRED, net of accumulated amortization of $349,438 and $285,834, respectively | 4,954,728 | 4,326,308 |
| OTHER ASSETS | 342,384 | 254,089 |
| | $ 31,049,134 | $ 31,268,067 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | $ 1,800,717 | $ 1,723,393 |
| Due to Medicare | 520,825 | 932,780 |
| Accrued salaries and benefits | 1,127,401 | 1,170,365 |
| Accrued expenses | 907,437 | 981,485 |
| Income taxes | 209,942 | 236,877 |
| Other accrued liabilities | 109,552 | 91,921 |
| Current portion of long-term obligations | 700,635 | 703,260 |
| TOTAL CURRENT LIABILITIES | 5,376,509 | 5,840,081 |
| LONG-TERM OBLIGATIONS | 2,409,406 | 2,655,908 |
| COMMITMENTS | | |
| COMMON STOCK – $.01 par value; authorized, 15,000,000 shares; issued and outstanding, 3,697,992 and 3,684,363, respectively | 36,979 | 36,843 |
| ADDITIONAL PAID-IN CAPITAL | 26,436,106 | 26,408,943 |
| ACCUMULATED DEFICIT | (3,209,866) | (3,673,708) |
| SHAREHOLDERS' EQUITY | 23,263,219 | 22,772,078 |
| | $ 31,049,134 | $ 31,268,067 |

(1) Derived from December 31, 1991 audited financial statements.

See notes to consolidated financial statements.

# NATIONAL REHABILITATION CENTERS, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Three Months Ended March 31, 1992 | Three Months Ended March 31, 1991 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | |
| Net earnings | $ 463,833 | $ 279,760 |
| Adjustments to reconcile net earnings to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 215,771 | 176,231 |
| Amortization of deferred compensation | 3,675 | – |
| Provision for uncollectible accounts | 415,930 | 304,717 |
| Deferred income taxes | 12,500 | – |
| Change in assets and liabilities net of effects from purchase acquisitions: | | |
| (Increase) decrease in: | | |
| Accounts receivable | (1,001,348) | (668,173) |
| Prepaids and other current assets | (168,893) | (57,350) |
| Increase (decrease) in: | | |
| Accounts payable | (160,095) | 60,163 |
| Due to Medicare | (445,971) | 272,461 |
| Accrued salaries and benefits | (142,482) | (56,831) |
| Accrued expenses | 1,247 | 104,020 |
| Income taxes | (26,932) | 3,954 |
| Other current liabilities | 21,146 | 39,026 |
| Deferred rent | (12,108) | 10,283 |
| NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES | (823,727) | 468,261 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | |
| Purchase of rehabilitation centers | (1,300,000) | (1,000,000) |
| Cash acquired in acquisitions | 166,169 | (6,446) |
| Additions to property and equipment | (474,722) | (107,637) |
| Disposals of property and equipment | 1,881 | – |
| (Increase) decrease in other assets | 23,918 | 13,589 |
| NET CASH USED IN INVESTING ACTIVITIES | (1,582,754) | (1,100,494) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | |
| Additions to long–term obligations | – | 168,657 |
| Principal payments on long–term obligations | (244,520) | (53,328) |
| Borrowings under notes payable | – | 86,000 |
| Payments on notes payable | – | (342,047) |
| Increase in advances to affiliate | – | (3,233) |
| Proceeds from issuance of common stock | 23,624 | 111,931 |
| NET CASH USED IN FINANCING ACTIVITIES | (220,896) | (32,020) |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (2,627,377) | (664,253) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 18,537,004 | 2,271,918 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $ 15,909,627 | $ 1,607,665 |

See notes to consolidated financial statements.

## NATIONAL REHABILITATION CENTERS, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Three Months Ended March 31, 1992 | Three Months Ended March 31, 1991 |
|---|---|---|
| **SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION:** | | |
| Cash paid for: | | |
| Interest | $ 66,272 | $ 82,000 |
| Taxes | $ 312,007 | $ 56,000 |

See notes to consolidated financial statements.

## NATIONAL REHABILITATION CENTERS, INC.
## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
## MARCH 31, 1992

### A. Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments consisting of normal recurring accruals considered necessary for a fair presentation have been included.

These financial statements, footnote disclosures and other information should be read in conjunction with the financial statements and the notes thereto included in the Company's Form 10-K (File No. 33-42783) filed on March 30, 1992.

### B. Earnings Per Share

Earnings per share is computed by dividing net earnings by the weighted average number of common shares and common shares equivalent outstanding.

### C. Acquisitions

On January 1, 1992, the Company acquired the assets and assumed all liabilities of a partnership which operates a rehabilitation center in Orlando, Florida. The Company was formerly the general partner of the partnership and managed the rehabilitation center pursuant to a management agreement. In the first quarter of 1991, net patient service revenue included $65,000 in management fees from the partnership. The acquisition was accounted for as a purchase.

Effective April 1, 1992, the Company acquired substantially all of the assets and assumed substantially all of the liabilities of The Center for Spinal Evaluation & Rehabilitation and related entities (the "Business"). The Business owned and operated an outpatient rehabilitation center in Lubbock, Texas. The acquisition was accounted for as a purchase. The purchase price was: (i) $2,500,000 paid in cash, (ii) a promissory note bearing interest at six percent (6%) in the original principal amount of $1,800,000 payable over four years secured by the assets acquired and future acquired assets, (iii) 85,437 shares of the Registrant's common stock, and (iv) the assumption by the Company of all the liabilities of the sellers, which is estimated to be approximately $75,000. The terms of the agreement meet the conditions qualifying the acquisition as a significant subsidiary. It is impracticable to provide the required proforma financial information at this time. Such information will be filed as available.

# NATIONAL REHABILITATION CENTERS, INC.
## Management's Discussion and Analysis of the Financial Condition and Results of Operations

### Results of Operations

For the three months ended March 31, 1992, the Company's net patient service revenue was $8,004,000 compared to $4,911,000 for the first quarter of 1991, an increase of 63%. Net patient service revenue of centers owned for two or more comparable reporting periods increased to 25%. Total patient visits for the first quarter was 97,136 versus 61,857 for visits the same period a year ago. This represented an increase of 57%.

Total operating expenses for the quarter ended March 31, 1992 were $7,372,000 compared to $4,517,000 for the first quarter of 1991. Payroll and benefits represented 48% of net patient service revenue for the quarter ended March 31, 1992 versus 44% for the first quarter of 1991. For the first quarter of 1992, the Company's operating margin was 7.9% versus 8.0% for the same period in 1991.

Earnings before extraordinary item for the three months ended March 31, 1992 were $464,000 compared to $209,000 for the same period in 1991, an increase of 122%. Net earnings for the first quarter were up 66% to $464,000 from $280,000 in 1991.

Earnings per common share before extraordinary item increased 33% to $0.12 versus $0.09 with 69% more shares outstanding. The weighted average shares outstanding in the first quarter of 1992 were 3,951,000 compared to 2,332,000 for the comparable period in the previous year. Earnings per common share after extraordinary item were $0.12 compared to $0.12 per share in the first quarter of 1991.

On January 1, 1992, the Company acquired the assets and assumed all liabilities of a partnership which operates a rehabilitation center in Orlando, Florida. The Company was formerly the general partner of the partnership and managed the rehabilitation center pursuant to a management Agreement. In the first quarter of 1991, net patient service revenue included $65,000 in management fees from the partnership.

### Liquidity and Capital Resources

On November 6, 1991, the Company completed an initial public offering of its common stock which provided the Company with cash proceeds of approximately $16.7 million, not including estimated offering costs of approximately $500,000.

Cash and cash equivalents at March 31, 1992 were $15,910,000. Net cash used in operations was $824,000. In the first quarter, the Company paid $604,000 to Medicare intermediaries in initial settlements of 1991 cost reports and $312,000 in Federal and State income taxes. The Company also purchased a rehabilitation center for $1,300,000 cash. Capital expenditures for the quarter were $475,000, which consisted primarily of computer and physical therapy equipment. Payments on long term obligations totaled $245,000.

Net accounts receivable as of March 31, 1992 were $5,144,000. Net accounts receivable days outstanding for the first quarter were 62 days.

The Company has a $2.5 million revolving credit facility with a commercial bank, which is available for acquisition funding, working capital and letters of credit. As of March 31, 1992, the company had $200,000 outstanding under this facility.

The Company believes that the revolving credit facility and cash and cash equivalents of $15,910,000 as of March 31, 1992 will be sufficient to meet the Company's capital requirements through the year ending December 31, 1992.

## NATIONAL REHABILITATION CENTERS, INC.

## FOR THE THREE MONTHS ENDED MARCH 31, 1992

| | | |
|---|---|---|
| PART II. | Other Information | |
| Item 1. | Legal Proceedings | None |
| Item 2. | Changes in Securities | None |
| Item 3. | Defaults Upon Senior Securities | None |
| Item 4. | Submission of Matters to a Vote of Security Holders | None |
| Item 5. | Other Information | None |
| Item 6. | Exhibits and Reports on Form 8-K (17 CFR 249.308) | |
| | (a.) Exhibits | |
| | Exhibit 11 – Computation of Earnings Per Common and Common Equivalent Share | p.11 |
| | (b.) Reports on Form 8-K | None |

EXHIBIT 11

## NATIONAL REHABILITATION CENTERS, INC. AND SUBSIDIARIES

## COMPUTATION OF EARNINGS PER COMMON AND COMMON EQUIVALENT SHARE

| | Three Months Ended March 31, 1992 | Three Months Ended March 31, 1991 |
|---|---|---|
| **PRIMARY** | | |
| Net Earnings as Reported: | | |
| Before extraordinary item | $ 463,833 | $ 208,623 |
| Extraordinary item | – | 71,137 |
| Net earnings | $ 463,833 | $ 279,760 |
| Weighted Average Shares Outstanding: | | |
| Common shares outstanding | 3,690,596 | 1,891,158 |
| Redeemable preferred stock | – | 275,196 |
| Common share equivalents (a) | 260,421 | 108,462 |
| Other dilutive securities (b) | – | 57,366 |
| Total | 3,951,017 | 2,332,182 |
| Primary Earnings per Common and Common Equivalent Share: | | |
| Before extraordinary item | $ 0.12 | $ 0.09 |
| Extraordinary item | 0.00 | 0.03 |
| Net earnings | $ 0.12 | $ 0.12 |
| **FULLY DILUTED** | | |
| Net Earnings as Reported: | | |
| Before extraordinary item | $ 463,833 | $ 208,623 |
| Extraordinary item | – | 71,137 |
| Net earnings | $ 463,833 | $ 279,760 |
| Interest savings (net of tax) (c) | $ – | $ 12,500 |
| Net Earnings as Adjusted: | | |
| Before extraordinary item | $ 463,833 | $ 221,123 |
| Extraordinary item | – | 71,137 |
| Net earnings | $ 463,833 | $ 292,260 |
| Weighted Average Shares Outstanding: | | |
| Common shares outstanding | 3,690,596 | 1,891,158 |
| Redeemable preferred stock | – | 275,196 |
| Convertible debt | – | 63,742 |
| Common share equivalents (a) | 260,421 | 121,522 |
| Other dilutive securities (b) | – | 57,366 |
| Total | 3,951,017 | 2,408,984 |
| Fully Diluted Earnings per Common and Common Equivalent Share: | | |
| Before extraordinary item | $ 0.12 | $ 0.09 |
| Extraordinary item | 0.00 | 0.03 |
| Net earnings | $ 0.12 | $ 0.12 |

(a) Dilutive effect of options and warrants calculated using the treasury stock method, modified for options and warrants in excess of 20% of outstanding shares, of which the assumed proceeds from exercise are assumed to be used to pay off debt.

(b) Dilutive effect of options issued during the twelve months prior to The Company's initial public offering at a price below the initial public offering price.

(c) Interest savings resulting from the presumed conversion of $500,000 bridge loans.

# SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf of the undersigned thereunto duly authorized.

NATIONAL REHABILITATION CENTERS, INC.
(REGISTRANT)

Date: May 14, 1992

By: William F. Youree
William F. Youree
President, Chief Executive Officer and Director

Date: May 14, 1992

By: Stephen M. Mengert
Stephen M. Mengert
Vice President of Finance and Chief Financial Officer

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# FORM 10-Q

## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

RECD S.E.C.
MAY 15 1992
132

(Mark One)

X Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 1992

OR

____ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ____ to ____

Commission File Number 1-10361

**NDE ENVIRONMENTAL CORPORATION**
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 95-3634420 |
| (State of Incorporation) | (IRS Employer Identification No.) |

BEST COPY AVAILABLE

20000 Mariner Avenue, Suite 500, Torrance, California 90503
(Address of Principal Executive offices) (Zip Code)

Registrant's telephone number, including area code (310) 542-4342

---

Indicate by check-mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past ninety days.

YES X NO ____

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding at April 30, 1992 |
|---|---|
| Common | 4,719,415 shares |

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This report consists of 18 sequentially numbered pages.

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Part I.

ITEM 1. Financial Information

## NDE ENVIRONMENTAL CORPORATION AND SUBSIDIARY
## CONDENSED CONSOLIDATED BALANCE SHEETS

### ASSETS

| | March 31, 1992 | December 31, 1991 |
|---|---|---|
| CURRENT ASSETS | (Unaudited) | |
| Cash | $326,821 | $644,372 |
| Trade accounts receivable, less allowance for doubtful accounts of $362,545 in 1992 and $319,810 in 1991 | 1,483,807 | 1,852,597 |
| Inventories | 347,041 | 309,452 |
| Prepaid expenses and other current assets | 242,714 | 216,323 |
| Total Current Assets | 2,400,383 | 3,022,744 |
| NOTE RECEIVABLE FROM OFFICER | 70,000 | 70,000 |
| EQUIPMENT AND IMPROVEMENTS, net of accumulated depreciation of $1,706,266 in 1992 and $1,473,542 in 1991 (Note 2) | 4,157,068 | 4,331,044 |
| COST in excess of fair value of assets acquired, net of accumulated amortization of $218,299 in 1992 and $176,299 in 1991 | 3,197,182 | 3,239,182 |
| PATENTS, net of accumulated amortization of $65,800 in 1992 and $59,305 in 1991 | 256,077 | 262,572 |
| DEPOSITS | 54,102 | 52,043 |
| | $10,134,812 | $10,977,585 |

See Notes to Condensed Consolidated Financial Statements

# NDE ENVIRONMENTAL CORPORATION AND SUBSIDIARY
# CONDENSED CONSOLIDATED BALANCE SHEETS

## LIABILITIES AND STOCKHOLDERS' EQUITY

| | March 31, 1992<br>(Unaudited) | December 31, 1991 |
|---|---|---|
| **CURRENT LIABILITIES** | | |
| Accounts payable | $1,360,440 | $1,898,694 |
| Accrued compensation payable to officers | 35,564 | 35,564 |
| Accrued liabilities | 589,351 | 267,978 |
| Accrued payroll and payroll taxes | 115,045 | 48,698 |
| Current maturities of notes payable and long-term debt (Note 3) | 605,000 | 708,712 |
| Current portion of capital lease obligation | 74,659 | 93,528 |
| Accrued restructuring costs | 1,324,013 | 1,806,305 |
| Total Current Liabilities | 4,104,072 | 4,859,479 |
| Liability to former stockholder | 84,490 | 84,490 |
| Notes payable and long-term debt | 9,431 | 9,431 |
| Capital lease obligation, less current portion | 228,639 | 234,062 |
| Advance from investors (Note 3) | 1,150,000 | --- |
| Commitments and contingencies | | |
| Subsequent event (Note 5) | | |
| Stockholders' Equity (Notes 4 and 5): | | |
| Series B Convertible Preferred stock, $.0001 par value; authorized, 1,000 shares; issued and outstanding 550 shares stated at liquidation value of $5,000 per share | 2,750,000 | 2,750,000 |
| Series A Convertible Preferred stock, $.0001 par value; authorized, 1,275 shares; issued and outstanding 1,212.75 shares stated at liquidation value of $5,000 per share | 6,063,750 | 6,063,750 |
| Common stock, $.0001 par value; authorized, 15,000,000 shares; issued and outstanding 4,576,915 in 1992 and 4,576,915 in 1991 | 458 | 458 |
| Additional paid-in capital | 11,040,221 | 11,040,221 |
| Retained deficit | (15,296,249) | (14,064,306) |
| Total Stockholders' Equity | 5,708,180 | 5,790,123 |
| | $10,134,812 | $10,977,585 |

See Notes to Condensed Consolidated Financial Statements

# NDE ENVIRONMENTAL CORPORATION AND SUBSIDIARY
# CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
## (UNAUDITED)

| | Three Months Ended March 31, | |
|---|---|---|
| | 1992 | 1991 |
| **REVENUES** | | |
| Testing services and equipment sales | $1,416,923 | $689,746 |
| Royalties | 4,035 | 16,066 |
| Interest | 537 | 20,061 |
| Other | -- | 14,805 |
| | 1,421,495 | 740,678 |
| **COSTS AND EXPENSES** | | |
| Cost of Sales and Testing Services | 1,352,097 | 857,131 |
| Selling, General and Administrative | 1,284,341 | 834,879 |
| Research & Development | -- | 131,636 |
| Interest | 17,000 | 6,273 |
| | 2,653,438 | 1,829,919 |
| **NET LOSS** | ($1,231,943) | ($1,089,241) |
| **NET LOSS PER SHARE** | ($0.27) | ($0.44) |
| **WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING** | 4,576,915 | 2,476,815 |

See Notes to Condensed Consolidated Financial Statements

## NDE ENVIRONMENTAL CORPORATION
## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
## (UNAUDITED)

| | Three Months Ended March 31, | |
|---|---|---|
| | 1992 | 1991 |
| **Operating activities** | | |
| **Net loss** | ($1,231,943) | ($1,089,241) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 232,724 | 144,585 |
| Amortization of intangibles | 48,495 | 13,995 |
| Provision for doubtful accounts | 42,735 | -- |
| Changes in operating assets and liabilities: | | |
| Decrease (Increase) in trade receivables | 326,055 | (61,709) |
| (Increase) in inventories | (37,589) | (311,819) |
| (Increase) in prepaid expenses | (26,391) | (92,078) |
| (Increase) in other assets | (2,059) | |
| (Decrease) Increase in accounts payable and accrued expenses | (216,881) | 2,412 |
| Increase in accrued compensation payable to officers | -- | 7,000 |
| Increase in accrued payroll and accrued payroll taxes | 66,347 | 1,194 |
| (Decrease) in accrued restructuring costs | (482,292) | |
| Net cash used in operating activities | ($1,280,799) | ($1,385,661) |

# NDE ENVIRONMENTAL CORPORATION
# CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
# (UNAUDITED)

| | Three Months Ended March 31, | |
|---|---|---|
| | 1992 | 1991 |
| **Investing activities** | | |
| Additions to equipment and improvements and software | ($62,642) | ($87,520) |
| Proceeds from sale of equipment | 3,894 | -- |
| Loans/advances to officers | -- | (4,744) |
| Net cash used in investing activities | ($58,748) | ($92,264) |
| **Financing activities** | | |
| Proceeds from advance from investors | 1,150,000 | -- |
| Proceeds from issuance of notes payable | 250,000 | -- |
| Principal payments under note and capital lease payable | (378,004) | (83,822) |
| Net cash provided by financing activities | 1,021,996 | (83,822) |
| Net (decrease) in cash | (317,551) | ($1,561,747) |
| Cash and cash equivalents at beginning of year | 644,372 | 2,417,282 |
| Cash and cash equivalents at end of year | $326,821 | $855,535 |
| Supplemental disclosure of cash flow information | | |
| Cash paid during the year for: | | |
| Interest | $10,056 | $6,273 |
| Income taxes | -- | -- |

Non-cash transactions:
During the three months ended March 31, 1991 the Company issued a $275,000 dividend in the form of 55 shares of Series "A" Preferred Stock.

See accompanying notes

# NDE ENVIRONMENTAL CORPORATION AND SUBSIDIARY
# NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

## NOTE 1 ACCOMPANYING UNAUDITED FINANCIAL STATEMENTS

Basis of Presentation: The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial reporting and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required for complete financial statements.

In the opinion of the Company, the accompanying unaudited financial statements for the three months ended March 31, 1992 and 1991 contain all adjustments, consisting of only normal recurring accruals, necessary to present fairly the financial position of the Company as of March 31, 1992 and 1991 and the results of operations and cash flows for the three months then ended.

For further information refer to the financial statements and footnotes included in the Company's annual report on Form 10-K for the year ended December 31, 1991.

Certain amounts shown in the 1991 financial statements have been reclassified to conform to the 1992 presentation.

Principles of Consolidation: The condensed consolidated financial statements include the accounts and operations of NDE Environmental Corporation ("NDE Environmental") and its wholly-owned subsidiary, NDE Testing & Equipment, Inc. ("NDE Testing"). All significant intercompany accounts have been eliminated in consolidation.

Inventories: Inventories consist principally of operational supplies used by the Company in the performance of testing services or the maintenance of its testing equipment and are valued at lower of cost (first in, first out) or market.

### Results of Interim Periods

The results of operations for the Company's interim periods are not necessarily indicative of the results to be expected for the entire year.

NOTE 2 Equipment and Improvements: Equipment and improvements, including capital leases, are stated at cost. Depreciation is computed on the straight-line method over the estimated useful lives of the assets of between three and five years. Capital leases and leasehold improvements are amortized over the shorter of; the estimated useful lives, or the term of the leases, using the straight-line method. Amortization of capital leases is included in depreciation expense.

Equipment and improvements consist of the following:

| | March 31, 1992 | December 31, 1991 |
|---|---|---|
| Proprietary Test Equipment | $5,047,596 | $5,032,126 |
| Vehicles | 485,785 | 485,785 |
| Furniture and Fixtures | 275,740 | 232,462 |
| Leasehold Improvements | 54,213 | 54,213 |
| Total | 5,863,334 | 5,804,586 |
| Less: Accumulated Depreciation and amortization | 1,706,266 | 1,473,542 |
| Net Equipment and Improvements | $4,157,068 | $4,331,044 |

NOTE 3 ADVANCES FROM INVESTORS

The Company is negotiating an agreement clarifying the status of $1,400,000 received by the company from a group of investors during the quarter ending March 31, 1992 (Note 2 in the Company's annual report on Form 10-K for the year ended December 31, 1991 and Item 5. of this report). The cash represented a $1,150,000 advance for a future equity infusion from a group of investors lead by Spears Benzak Salomon & Farrell (SBSF), and a 60 day note payable due April 30, 1992 for $250,000 from Proactive Partners. Under the terms of a Proposed Financing being negotiated with SBSF, Proactive Partners and other investors, this advance and note, together with an additional note payable to SBSF in the amount of $250,000 for funds advanced in 1991 would be converted into equity securities of the Company, see part II, Item 5 of this Quarterly Report on Form 10-Q. There can be no assurance that the Proposed Financing will be consummated.

As of March 31, 1992, the Company has shown $1,150,000 of the amounts received as an advance from investors. The $500,000 of notes payable to be converted to BBB Preferred are shown as part of the $605,000 notes payable outstanding at March 31, 1992.

## NOTE 4 Proposed Financing

The Company is negotiating a series of proposed agreements to provide a cash infusion to the Company. The Proposed Financing is referred to in Part II, Item 5.

If the proposed financing is consummated, it will significantly dilute the interest of the current common shareholders on a fully diluted basis.

## NDE ENVIRONMENTAL CORPORATION AND SUBSIDIARY

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

NDE Environmental Corporation (the "Company") provides services for detecting leaks in underground storage tanks ("USTs") and associated piping ("lines").

The Company's principal leak detection technology has traditionally been its VPLT System, a precision tank testing system based on measurements of volume, pressure, level and temperature. In mid-1991, the Company introduced the NDE UTS-4T Tank Test System, an expanded system for precision testing of the unfilled tank and line area. The NDE UTS-4T System permits testing with the same high degree of accuracy as the VPLT System but without having to incur the cost and delay of adding and mixing liquids. Both systems, which are marketed together as the NDE 1000 System, have been certified by independent laboratories as meeting Environmental Protection Agency ("EPA") regulations for testing USTs containing gasoline, oil and other hazardous materials.

### Results of Operations

The Company had a net loss of $1,231,943 for the three months ended March 31, 1992 compared to a net loss of $1,089,241 for the three months ended March 31, 1992. An explanation of the variance between periods for each of the major categories follows.

The following table reflects the percentage relationship to net sales of certain items included in the company's statement of operations for each of the three month periods ended March 31, 1992 and March 31, 1991.

| | March 31, 1992 | March 31, 1991 |
|---|---|---|
| Revenues | 100% | 100% |
| Costs and Expenses | | |
| Cost of Sales and Testing | 95% | 116% |
| Selling, General and Administrative | 91% | 113% |
| Research and Development | --- | 18% |
| Interest | 1% | --- |
| Total Costs and Expenses | 187% | 247% |
| Net Loss | (87)% | (147)% |

## NDE ENVIRONMENTAL CORPORATION AND SUBSIDIARY
## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

The following table shows the dollar and percent change from the three months ended March 31, 1991 as compared to the three months ended March 31, 1992.

| | Increase (Decrease) $ | Increase (Decrease) % |
|---|---:|---:|
| Revenues | $680,817 | 92% |
| Costs and expenses | | |
| Cost of Sales and Testing | 494,966 | 58% |
| Selling, General and Administrative | 449,462 | 54% |
| Research and Development | (131,636) | 100% |
| Interest | 10,727 | 171% |
| Total Costs and Expenses | $823,519 | 45% |
| Net Loss | $142,702 | 13% |

### Revenues

Revenues for the three months ended March 31, 1992 were $1,421,495 an increase of $680,817 or 92% compared to the three months ended March 31, 1991. The increase was due to the expansion in 1991 of the Company's fleet of testing vehicles and testing personnel as a result primarily of the acquisition of assets from Kaneb Metering Corporation (KMC) in April 1991. In addition, average pricing for testing services increased in the first quarter of 1992 as compared to the first quarter of 1991.

The Company increased its testing and parts sales by $727,177 or 105% in the first quarter of 1992 compared to the first quarter of 1991. This was due primarily to the factors referred to immediately above.

The Company had a decrease in royalty income of $12,031 or 75% in the first quarter of 1992 compared to the first quarter of 1991. The Company generates the majority of its revenue from directly providing services to customers and has decreased the use of licensees to provide services. Other revenue decreased in the first quarter of 1992, $14,805 or 100% compared to the first quarter of 1991 as the Company phased out research and development activity which previously generated small amounts of specialized consulting services.

Interest income decreased $19,524 or 97% in the first quarter of 1992, compared to the first quarter of 1991 primarily due to reduced cash balances.

## Cost of Sales and Testing

Cost of sales and testing for the three months ended March 31, 1992 was $1,352,097 an increase of $494,966 or 58% compared to the three months ended March 31, 1991. The acquisition of additional testing assets and personnel and the increased revenue activity referred to above were primarily responsible for the increased costs. The margin between sales and cost of sales and testing was a positive $69,398 for the first quarter of 1992, compared to a negative $116,453 for the first quarter of 1991.

The Company proceeded with a major restructuring program during the first quarter of 1992. This restructuring, described footnote 2 of in the financial statements included in the Company's Annual Report on Form 10-K, was carried out during the traditionally slowest period for tank testing. Even though the costs of restructure were accrued for in 1991, the disruption still has an adverse effect on the Company's ability to perform efficiently.

In April 1992, the Company decreased its operations workforce and vehicles in service in order to lower costs and raise the current utilization of its active testing vehicles.

## Selling, General & Administrative

Selling, general & administrative expenses for the three months ended March 31, 1992 were $1,284,341, an increase of $449,462 or 54% compared to the three months ended March 31, 1991. The increase was due primarily to the expansion of business activity resulting from the acquisition of KMC assets in April 1991. As noted above, the restructuring activities had an effect on the efficiency of the Company during the first quarter of 1992. In April 1992, the Company reduced its selling and administrative workforce by an additional 10%.

## Research & Development

The Company had no research and development cost in the first quarter of 1992 because the company conducted no research and development activities during the first quarter. As part of its restructuring plan, the Company decided to eliminate the in-house research and development activity and to concentrate on current operational activity. In the first quarter of 1991, the Company's research and development costs were $131,636.

### Interest Expense

Interest expense for the three months ended March 31, 1992 was $17,000, an increase of $10,727 or 171% compared to the three months ended March 31, 1991. The increase is due to increased borrowings in the first quarter of 1992 compared to the comparable quarter in 1991.

## LIQUIDITY AND CAPITAL RESOURCES

Since inception, the Company has financed its operations through the sale of debt and equity securities, trade credit and revenue from operations, including the sale of licenses. Of material impact to the Company's liquidity and capital resources were the $1,400,000 in financing received in March 1992 (see Note 3 and 4), the private placement of $2,750,000 of the Series B Stock and warrants in November 1991, the $1,600,000 in short term note financing in August through October 1991 (of which $1,000,000 was exchanged for Series B Stock), the acquisition of Kaneb's Underground Storage Tank testing assets, along with $3.5 million in cash, in April 1991, the sale for $5.5 million of the Series A Preferred in July 1990, and the Company's initial public offering in October 1989. The Company has used the funds described above for the acquisition of its subsidiary in March 1990, and for the operations of the business.

At the end of 1991, the Company had a working capital deficit of $1,836,735. At March 31, 1992 the Company had a working capital deficit of $1,703,689. The Company has not yet generated positive cash flow from operations. Accordingly, the Company depends upon financing from investors to supplement its operational cash flows until such time that it can generate sufficient cash flows from operations to meet its continuing costs. As of the date of this report, the Company, as indicated in notes 3, and 4 of the accompanying financial statements and in item 5 of this Quarterly Report on Form 10-Q, is negotiating a series of transactions which, if consummated, will result in additional capital to be received by the Company and will also result in, among other things, the issuance by the Company of securities that will be severely dilutive to the interest of the Company's existing security holders. If consummated along the lines of the current negotiations, the proposed financing would result in the holders of the Company's existing and/or newly issued Preferred Stock having the right to elect the majority of the Company's directors. If the proposed financing agreements are not promptly entered into, the Company will not be in a position to meet its current and continuing obligations and will likely be required to cease those operations. If the proposed financing agreements are promptly entered into, certain of the transactions will be conditioned upon approval by the Company's stockholders. Without such stockholder approval, the Company will be obligated to repay promptly the new capital it will have received, and it is not anticipated that the Company will be in a position to do so. Assuming that the required stockholder approval is obtained, the Company will have sufficient capital reserves to continue operations in the near term, but its ability to operate on a sustained basis will depend upon whether it achieves positive cash flow from continuing operations and may also depend upon obtaining further financing.

## PART II. OTHER INFORMATION

### ITEM 2: Changes in Securities

See Item 5: Other Information

### ITEM 3: Defaults Upon Senior Securities

In the course of the first quarter and at present the Company is not in compliance with all of the obligations of certain of its debt securities, but the Company is negotiating that these securities will be exchanged for other securities that are not in default of certain financing arrangements, are entered into as currently proposed. See Item 5: Other Information

### ITEM 5: Other Information

Negotiations Regarding New Financing

The Company is presently engaged in negotiations regarding the terms of a proposed new financing (the "Proposed Financing") with Josephthal Lyon & Ross ("Josephthal"), Spears Benzak Salomon & Farrell ("SBSF") and Proactive Partners, L.P. ("Proactive") and persons represented by them. The predecessor of Josephthal was the lead underwriter in the Company's initial public offering, and Josephthal and certain persons represented by Josephthal hold certain warrants issued by the Company to Josephthal's predecessor in that offering, the exchange of which for new warrants is currently contemplated (see "Warrant Exchange" below). SBSF and persons represented by SBSF together hold all of the outstanding shares of the Company's Series A Convertible Preferred Stock, as well as a substantial number of the outstanding shares of the Company's Series B Convertible Preferred Stock and Common Stock, and certain warrants. Proactive and persons represented by Proactive hold the majority of the outstanding shares of the Company's Series B Convertible Preferred Stock and hold certain warrants issued by the Company. The holdings of these persons are as set forth in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1991 filed with the Securities and Exchange Commission (the "1991-10-K").

A number of material terms of the Proposed Financing have not yet been determined, and no agreements with respect to the Proposed Financing have been reached. If consummated along the lines of the current negotiations, the Proposed Financing would involve a change of control of the Company so that a majority of the Board of Directors would no longer be elected by the Common stockholders, but would be elected by the holders of the Company's existing Preferred Stock to be created as part of the Proposed Financing. In addition, the Proposed Financing would be severely dilutive to existing stockholders.

It is anticipated that consummation of the Proposed Financing would be conditioned on the Company's resolution of a number of outstanding matters. One of these matters is settlement with John R. Mastandrea, the Company's current Chairman and a director. Certain preliminary settlement arrangements with Mr. Mastandrea were described in the 1991 10-K. Since the date of the 1991 10-K, the Company and Mr. Mastandrea have negotiated different settlement arrangements. Whether or not these arrangements are finalized may depend on what arrangements, if any, are agreed upon for the Proposed Financing.

Consummation of the Proposed Financing would also be contingent upon (a) working our arrangements for converting into other securities of the Company the Company's existing indebtedness of over $1,650,000 for funds advanced in 1992 and late 1991 by Proactive, SBSF and certain investors represented by SBSF and (b) settling the existing dispute with Josephthal and other holders of warrants issued by the Company in 1989 as to the effect of the antidilution provisions of those warrants. These matters are referred to in the 1991 10-K.

Under the terms of the Company's Series A Convertible Preferred Stock and Series B Convertible Preferred Stock, the holders of the outstanding shares of such stock have the right to declare a "voting default" which would permit them to elect a majority of the members of the Company's Board of Directors. As of the date of this report, the holders have not exercised that right. As indicated above, it is likely that the Proposed Financing, if consummated along the lines of the current negotiations, would redetermine the right of the Company's security holders to elect members of the Company's Board of Directors.

### Cancellation of Certain Royalty and Other Obligations

The arrangements with the "ATTS Shareholders" and "NAESS" described in Item 1 of the 1991 10-K have not yet been consummated as the Company has not yet made full payment as required by these arrangements.

## ITEM 6: Exhibits and Reports on Form 8-K

(a) The following exhibits are filed herewith:

None.

(b) The Company filed no reports on Form 8-K during the three months ended March 31, 1992.

# NDE ENVIRONMENTAL CORPORATION AND SUBSIDIARY

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed off on its behalf by the duly authorized undersigned.

NDE ENVIRONMENTAL CORPORATION
(Registrant)

Date: May 14, 1992

Jay Allen Chaffee
President, Chief Executive
Officer

Date: May 14, 1992

Joseph E. McCarthy

Joseph E. McCarthy
Chief Financial Officer and Secretary

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed off on its behalf by the duly authorized undersigned.

NDE ENVIRONMENTAL CORPORATION
(Registrant)

Date: May 14, 1992

/s/ Jay Allen Chaffee
Jay Allen Chaffee
President, Chief Executive
Officer

Date: May 14, 1992

/s/ Joseph E. McCarthy
Joseph E. McCarthy
Chief Financial Officer and Secretary

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

**BEST COPY AVAILABLE**

# Form 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For Quarter Ended
March 31, 1992

Commission
File Number - 0-18218

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## NEW EAST BANCORP

(Exact name of registrant as specified in charter)

| | |
|---|---|
| **North Carolina** | **56-1622191** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**One Hannover Square, Suite 1111, Raleigh, North Carolina 27602**
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (919) 821-1085

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X . No ___ .

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of May 13, 1992, the registrant has issued and outstanding 2,499,339 shares of $1.00 par value common stock.

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# NEW EAST BANCORP AND SUBSIDIARIES

## Consolidated Balance Sheets
March 31, 1992 and December 31, 1991

| ASSETS | March 31, 1992 (Unaudited) | December 31, 1991 |
|---|---|---|
| Cash and due from banks | $ 5,180,705 | 5,119,012 |
| Federal funds sold | 7,675,000 | 3,140,000 |
| Investment securities: | | |
| U.S. Treasury | 997,481 | 996,788 |
| U.S. Government agencies and corporations | 9,598,644 | 13,107,192 |
| Mortgage-backed securities and collateralized mortgage obligations | 11,408,252 | 12,072,523 |
| Other securities | 179,900 | 179,900 |
| Total investment securities (market value of approximately $ 22,654,455 and $27,212,053 at March 31, 1992 and December 31, 1991, respectively) | 22,184,277 | 26,356,403 |
| Loans | 90,483,998 | 77,932,899 |
| Less allowance for loan losses | (1,422,000) | (1,264,526) |
| Net loans | 89,061,998 | 76,668,373 |
| Premises and equipment, net | 9,086,714 | 8,242,009 |
| Accrued interest receivable | 1,235,472 | 1,537,776 |
| Other assets | 1,293,271 | 691,381 |
| Total assets | $ 135,717,437 | 121,754,954 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Deposits: | | |
| Demand (noninterest-bearing) | 11,134,110 | 9,672,182 |
| Demand (interest-bearing) | 9,771,986 | 6,364,606 |
| Savings accounts | 2,981,663 | 2,492,181 |
| Money market accounts | 25,120,209 | 20,597,704 |
| Time | 65,002,644 | 60,068,630 |
| Total deposits | 114,010,612 | 99,195,303 |
| Obligations under capital leases | 1,438,109 | 1,563,377 |
| Notes payable | 1,000,000 | 1,000,000 |
| Securities sold under agreements to repurchase | 615,000 | 1,380,000 |
| Other liabilities | 1,356,768 | 1,219,350 |
| Total liabilities | 118,420,489 | 104,358,030 |
| Shareholders' equity: | | |
| Preferred stock, $ 100 par value, 500,000 shares authorized, no shares issued or outstanding | - | - |
| Common stock, $ 1.00 par value, 5,000,000 authorized, 2,499,339 shares issued and outstanding in 1992 and 1991 | 2,499,339 | 2,499,339 |
| Additional paid-in capital | 20,720,327 | 20,720,327 |
| Accumulated deficit | (5,922,718) | (5,822,742) |
| Total shareholders' equity | 17,296,948 | 17,396,924 |
| Total liabilities and shareholders' equity | $ 135,717,437 | 121,754,954 |

*See accompanying notes to consolidated financial statements.*

## NEW EAST BANCORP AND SUBSIDIARIES

### Consolidated Statements of Operations
### For the three months ended March 31, 1992 and 1991
### (Unaudited)

| | 1992 | 1991 |
|---|---|---|
| Interest income: | | |
| Loans | $ 1,798,108 | 1,201,753 |
| Federal funds sold | 54,480 | 153,152 |
| Other | - | 32,124 |
| Investment securities | 489,870 | 385,513 |
| Total interest income | 2,342,458 | 1,772,542 |
| Interest expense: | | |
| Deposits | 1,237,837 | 1,126,106 |
| Securities sold under agreements to repurchase and federal funds purchased | 6,570 | - |
| Notes payable and capital lease obligations | 6,040 | 37,831 |
| Total interest expense | 1,250,447 | 1,163,937 |
| Net interest income | 1,092,011 | 608,605 |
| Provision for loan losses | (200,692) | (165,300) |
| Net interest income after provision for loan losses | 891,319 | 443,305 |
| Noninterest income: | | |
| Service charges on deposit accounts | 200,629 | 84,659 |
| Other service charges and fees | 6,632 | 10,889 |
| Gains on sales of investment securities | 104,143 | - |
| Total noninterest income | 311,404 | 95,548 |
| Noninterest expense: | | |
| Personnel | 574,645 | 486,894 |
| Net occupancy | 114,404 | 67,662 |
| Furniture and equipment | 121,616 | 90,546 |
| Printing and office supplies | 60,917 | 38,286 |
| Deposit and other insurance | 71,482 | 49,668 |
| Travel, administrative support and training | 62,736 | 46,538 |
| Telephone and communications | 69,835 | 43,626 |
| Legal and professional | 36,729 | 16,637 |
| Advertising | 28,899 | 15,097 |
| Other | 161,436 | 58,776 |
| Total noninterest expense | 1,302,699 | 913,730 |
| Net loss | $ (99,976) | (374,877) |
| Weighted average shares outstanding | 2,499,339 | 2,038,106 |
| Net loss per share | ($ .04) | ($ .18) |

*See accompanying notes to consolidated financial statements.*

## NEW EAST BANCORP AND SUBSIDIARIES

### Consolidated Statements of Shareholders' Equity
### For the three months ended March 31, 1992 and 1991
### (Unaudited)

| | Common stock | Additional paid-in capital | Accumulated deficit | Total |
|---|---|---|---|---|
| Balance at December 31, 1990 | $2,038,106 | 17,191,545 | (4,284,230) | 14,945,421 |
| Net loss | - | - | (374,877) | (374,877) |
| Balance at March 31, 1991 | $ 2,038,106 | 17,191,545 | (4,659,107) | 14,570,544 |
| Balance at December 31, 1991 | 2,499,339 | 20,720,327 | (5,822,742) | 17,396,924 |
| Net loss | - | - | (99,976 | (99,976) |
| Balance at March 31, 1992 | $ 2,499,339 | 20,720,327 | (5,922,718) | 17,296,948 |

*See accompanying notes to consolidated financial statements.*

# NEW EAST BANCORP AND SUBSIDIARIES

## Consolidated Statements of Cash Flows
For the three months ended March 31, 1992 and 1991
(Unaudited)

| | 1992 | 1991 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net loss | $ (99,976) | (374,877) |
| Adjustments to reconcile net loss to net cash used by operating activities: | | |
| Depreciation and amortization | 119,519 | 84,971 |
| Gains from sales of investment securities | (104,143) | - |
| Net increase in other assets | (486,547) | (46,849) |
| Net increase in accrued interest receivable | 326,138 | (177,635) |
| Provision for loan losses | 200,692 | 165,300 |
| Increase in other liabilities | 111,756 | 93,697 |
| Net cash used by operating activities | 67,439 | (255,393) |
| Cash flows from investing activities: | | |
| Purchase of premises and equipment | (812,655) | (753,882) |
| Purchase of investment securities | (504,844) | (5,109,642) |
| Maturities of investment securities | 2,142,997 | 4,100,000 |
| Sales of investment securities | 2,620,311 | - |
| Cash acquired, net of payments, in purchase of branches | 4,506,401 | - |
| Loan originations, net of repayments | (8,569,494) | (9,316,950) |
| Net cash used by investing activities | (617,284) | (11,080,474) |
| Cash flows from financing activities: | | |
| Proceeds from deposits, net | 6,036,806 | 11,223,176 |
| Repayment of obligations under capital leases | (125,268) | (118,415) |
| Net decrease in securities sold under agreements to repurchase | (765,000) | - |
| Net cash provided by financing activities | 5,146,538 | 11,104,761 |
| Net increase (decrease) in cash and cash equivalents | 4,596,693 | (231,106) |
| Cash and cash equivalents, beginning of period | 8,259,012 | 14,587,828 |
| Cash and cash equivalents, end of period | $ 12,855,705 | 14,356,722 |
| Supplemental disclosures of cash flow information - interest paid | $ 1,354,629 | 959,712 |

No cash was paid during the periods for income taxes.

*See accompanying notes to consolidated financial statements.*

# NEW EAST BANCORP AND SUBSIDIARIES

## Notes to Consolidated Financial Statements
March 31, 1992 and 1991
(Unaudited)

### (1) Financial statement presentation and management representation

The consolidated financial statements include the accounts and results of operations of New East Bancorp (the "Company") and its wholly-owned subsidiaries. All significant intercompany transactions and accounts are eliminated in consolidation.

The interim consolidated financial statements as of and for the three months ended March 31, 1992 and 1991 are unaudited. In the opinion of management, the consolidated financial statements contain all adjustments, consisting solely of normal recurring adjustments, necessary to present fairly, in all material respects, the consolidated financial position as of March 31, 1992 and the consolidated results of operations and cash flows for the aforementioned periods.

### (2) Per share information

Per share information is computed based on the weighted average number of common shares outstanding during each period.

### (3) Investment securities

A summary of investment securities as of March 31, 1992 follows:

| | Book value | Approximate market value |
|---|---|---|
| U.S. Treasury securities | $ 997,481 | $ 1,017,187 |
| U.S. Government agencies and corporations | 9,598,644 | 9,851,719 |
| Mortgage-backed securities and collateralized mortgage obligations | 11,408,252 | 11,605,649 |
| Other securities | 179,900 | 179,900 |
| Total investment securities | $ 22,184,277 | $ 22,654,455 |

### (4) Loans

A summary of loans as of March 31, 1992 and December 31, 1991 follows:

| | 1992 | 1991 |
|---|---|---|
| Commercial, financial and agricultural | $ 34,044,336 | 27,776,455 |
| Real estate - construction | 20,369,995 | 6,463,692 |
| Real estate - mortgage | 16,307,945 | 24,872,365 |
| Installment loans to individuals | 19,092,935 | 18,205,326 |
| Plus: net deferred loan fees | 668,787 | 615,061 |
| Total loans | $ 90,483,998 | 77,932,899 |

## (5) Allowance for loan losses

The allowance for loan losses is maintained at a level considered adequate to provide for potential loan losses based on management's evaluation of the loan portfolio, as well as prevailing and anticipated economic conditions. Activity in the allowance for loan losses for the three months ended March 31, 1991 and 1990 follows:

| | |
|---|---|
| Balance at beginning of quarter | $ 1,264,526 |
| Provision charged to operations | 200,692 |
| Allowance from purchased branches | 40,248 |
| Loan losses charged off, net of recoveries | (83,466) |
| Balance at end of quarter | $ 1,422,000 |

## (6) Stock options

Pursuant to the New East Bancorp 1989 Incentive Stock Option Plan, the Company may grant to employees and directors of the Company and its subsidiary banks options to purchase up to 10% of the total shares of common stock outstanding. The exercise price of all options will be the fair market value of the Company's stock on the date of grant. Total options granted as of May 12, 1992 were 188,750, with such options exercisable at a rate of 20% per year, with varying initial exercise dates beginning in October, 1990. No options granted have been exercised as of May 12, 1992.

## (7) Branch Acquisition

On January 31, 1992, New East Bank of the Cape Fear completed its purchase of two bank branches located in Wilmington, North Carolina. This purchase included the assumption of approximately $ 8,800,000 in deposits and $ 4,000,000 in loans. A premium of approximately $ 145,600 was paid for the branch acquisitions. The Bank plans to continue the branches' operations at their existing locations.

## *1992 Management's Discussion and Analysis*

This discussion evaluates the financial condition and results of operations of New East Bancorp (the "Corporation") and its wholly-owned subsidiaries, New East Bank of Goldsboro, New East Bank of Greenville, New East Bank of the Cape Fear, New East Bank of the Albemarle, and New East Bank of New Bern (collectively referred to as the "Banks") for the three months ended March 31, 1992 and 1991. When the discussion concerns the holding company unconsolidated with the Banks, the Corporation will be referred to as the "Holding Company". The discussion is intended to complement the accompanying consolidated financial statements and the supplemental financial data appearing elsewhere in this report and should be read in conjunction therewith.

### Capital Resources and Liquidity

The primary source of the Holding Company's capital resources through March 31, 1992 was the net proceeds from the Holding Company's initial public offering completed in October 1989 and a second public offering completed in March 1991. Of the original capital raised, the Holding Company had capital of $ 1,719,666 remaining after its investment in the Banks of $ 21,500,000.

The Holding Company has incurred various costs on behalf of the Banks, but has not recouped those costs fully through service fees charged to the Banks to help the Banks achieve profitable operations as soon as possible. Consequently, the Holding Company has been operating at a loss since inception. In addition, the Holding Company has purchased premises and equipment to be used for the benefit of the Banks for which it has not received reimbursement from the Banks. As the sum of the Holding Company's accumulated deficit and the cost of acquisition of the aforementioned premises and equipment exceeded the capital available after the Holding Company's investment in the Banks, the Holding Company has incurred a substantial cash flow deficit as of March 31, 1992.

The Holding Company's cash flow deficit primarily began in 1991 and increased steadily throughout the year and continued into 1992. The Holding Company's operations and its capital acquisitions were funded in part through certain intercompany borrowings from the Banks. Consequently, the Holding Company owes the Banks approximately $ 3,261,800 at March 31, 1992 which must be repaid by the Holding Company (an increase of $ 39,800 from the balance at December 31, 1991.) These borrowings were in violation of certain federal banking regulations and were not discovered until February 1992 primarily due to delays in recording internal accounting transactions between the Holding Company and the Banks. The consolidated financial statements of the Corporation are not affected by these intercompany borrowings since these amounts eliminate in consolidation. This situation, however, does create a liquidity problem for the Holding Company because it does not have sufficient existing resources to fund the obligation. In addition to the liability to the Banks, the Holding Company's existing line of credit which has an outstanding balance of $ 1 million at March 31, 1992 is due May 1, 1992. The line of credit outstanding was reduced to $ 200,000 on May 1, 1992 by funds provided by the transfer of the newly constructed permanent facility for New East Bank of Greenville from the Holding Company to the Bank. Management intends to repay the remainder of the line of credit by the end of May 1992. Management is reviewing the alternatives for obtaining funds to repay the Holding Company's obligation to the Banks, including, without limitation, selling subordinated debentures in a private placement, transferring assets purchased for the benefit of the Banks to the Banks, procuring a commercial loan to replace its existing line of credit, or procuring a secured loan from the Banks that meets regulatory requirements. There can be no assurances as to the availability, structure, pricing and terms of such future financing. Certain alternatives to resolve this matter must be approved by bank regulatory authorities. Management and the Board of Directors are reviewing the Corporation's 1992 income and expense projections and the Corporation's internal accounting controls and management information systems to determine what changes are advisable to prevent such a situation from recurring.

To recoup more of the costs incurred by the Holding Company for the benefit of the Banks, management has increased the service fees charged to the Banks beginning in the second quarter of 1992. This increase may temporarily delay the Banks' reaching profitability. Management and the Board of Directors are carefully examining the Holding Company's charges to the Banks to determine whether the service fees should be further increased to the fair market value of the services provided or whether Holding Company expenses should be cut and base service fees decreased to maximize the profitability of both the Holding Company and the Banks. The second quarter increase in service fees charged by the Holding Company for its services on the Banks' behalf does not relate to the funding of the Holding Company's obligation to the Banks as described above. For the foreseeable future, payments from the Banks to the Holding Company will be limited to these service fees since North Carolina banking laws and regulatory policy restrict the payment of dividends by the Banks; generally, the Banks' dividends are restricted until the Banks' original capital is replenished from profitable operations. As the Banks continue to grow and mature, service fees and dividends paid by the Banks to the Holding Company are expected to provide the Holding Company with adequate liquidity.

Capital expenditures for the Corporation and the Banks' premises and equipment are expected to be permanently funded through long-term mortgage and lease financing. It is currently anticipated that the Banks will own their own permanent facilities. The permanent facility for New East Bank of Goldsboro is complete and in use; the permanent facility for New East Bank of Greenville is under construction and is substantially complete. Management anticipates that permanent facilities for the other three Banks will be completed by the end of 1994 at a cost of approximately $ 1,200,000 per facility. To finance construction of future permanent facilities, the Corporation anticipates obtaining a line of credit from a commercial bank.

To complete the New East Bancorp system, management will evaluate potential acquisitions of existing financial institutions from time to time and/or the formation of additional de novo banks in the market area. The capitalization of any additional banks would require additional capital resources from other sources, which may include the proceeds from the issuance of additional securities by the Corporation. In completing the system, management may determine to merge, reconstitute or expand existing regions of its market area. Out-of-market area acquisitions might be considered if such acquisitions would prove beneficial to the New East Bancorp system.

### Capital Requirements

The Federal Reserve Board's risk-based capital rules for bank holding companies, which became effective March 15, 1989, are being phased in over two years. When the rules become final at the end of 1992, the minimum guidelines for the ratio of capital to risk-weighted assets (including certain off-balance sheet items, such as standby letters of credit) will be 8 percent. At least half of the total capital must be composed of common equity, retained earnings, minority interests in equity accounts of consolidated subsidiaries, and a limited amount of perpetual preferred stock less certain goodwill items ("Tier 1 capital"). The remainder ("Tier 2 capital") may consist of a limited amount of subordinated debt, other preferred stock, hybrid capital instruments, perpetual debt, mandatory convertible debt securities, and a limited amount of loan loss reserves.

In addition, the Federal Reserve Board requires bank holding companies to maintain a minimum leverage ratio of Tier 1 capital to adjusted average quarterly assets of 3 percent with all but the strongest institution required to maintain a ratio of up to 5 percent. An even higher leverage ratio may be required depending on the circumstances. In adopting such standards, the Federal Reserve Board emphasized that in all cases the suggested standards are supervisory minimums and that an institution would be permitted to maintain the minimum levels of capital only if it were a strong banking organization with well-diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and rated composite 1 under the BOPEC rating system for bank holding companies. Any institution like the Corporation experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions, well above the minimum required levels. In addition, the Federal Reserve Board considers a "tangible Tier 1 leverage ratio" in evaluating proposals for expansion of new activities. The tangible Tier 1 leverage ratio is the ratio of a banking organization's Tier 1 capital, less all intangibles to total assets, less all intangibles. The FDIC, and the Federal Reserve Board as to member banks, impose similar minimum ratios of capital to risk-weighted assets and minimum leverage ratios on the Banks.

At March 31, 1992, the Corporation's ratio of total capital to risk-weighted assets of 16.16 percent exceeded the fully phased-in minimum guidelines applicable to bank holding companies. The Corporation's leverage ratio of 15.08 percent exceeded the required interim minimum leverage ratio of from 3 to 5 percent. The Banks are all also above such required ratios.

Under the Federal deposit Insurance Corporation Improvement Act of 1991 (the "Act") regulatory supervision is linked to bank capital. Regulatory agencies must set five capital levels for bank, ranging from well capitalized to critically undercapitalized. Regulatory action would be mandatory as capital levels fell. These new regulatory parameters must be in place by December 1992. Management of the Corporation cannot at this time assess the effect that these new regulations might have on the Corporation in the future.

### Liquidity and Interest Sensitivity

In banking, liquidity is necessary to ensure adequate funds are available to meet deposit withdrawals, fund loan commitments, maintain reserve requirements, pay operating expenses and meet other commitments. Funds are made available primarily through the expansion of the deposit base. As of March 31, 1992, consolidated total deposits were $ 114,010,612 which represents an increase of $ 14,815,309 or 15 percent over December 31, 1991, while consolidated net loans were $ 89,061,998, a 16 percent increase over December 31, 1991. These increases were the result of the continued growth of the Banks and the purchase of approximately $ 4,000,000 of loans in branch acquisitions. Investment securities have decreased by approximately $ 1,954,800 since December 31, 1991, primarily as a result of the maturing of some investment securities and the sales of other investment securities which was done to restructure the Banks' balance sheets. Federal funds sold have increased by $ 4,535,000 since year-end 1991 due primarily to excess cash received in the settlement from the branch acquisitions that have not yet been reinvested in loans or investment securities.

**Results of Operations**
The following covers the results of operations of the Corporation for the three months ended March 31, 1992 and 1991. The Corporation was incorporated in 1988; the initial three subsidiary banks opened in late 1989 and the last two subsidiary banks opened in mid-1990 and mid-1991, respectively.

The Corporation incurred a net loss for the three months ended March 31, 1992, of $ 99,976 compared to a net loss of $ 374,877 for the three months ended March 31, 1991. The consolidated losses from operations decreased in 1992 compared to 1991 due to gains on sales of securities of $ 104,143, the continued growth of the Banks and an effort by management to minimize costs where possible. Consolidated net loss was impacted primarily by an increase in net interest income of $ 483,406 which was partially off-set by increases in the provision for loan losses of $ 35,392 over the same period in 1991. Noninterest income, primarily service charges on deposit accounts, increased $ 215,856 over 1991 due to gains on sales of investment securities of $ 104,143 and a 136 percent increase in income from service charges on deposit accounts. The gains on sales of investment securities occurred due to the Banks restructuring their balance sheets to achieve their desired liquidity levels and to fund the acquisition of fixed assets from the Holding Company. Such gains are of a nonrecurring nature and additional significant gains from the sales of investment securities are not anticipated during the remainder of 1992 unless further restructuring of the Banks' balance sheets is needed.

Noninterest expense items that significantly increased in 1992 over their 1991 levels were occupancy, furniture and equipment ($ 77,812 or 49 percent increase) due to the opening of the operations center in Selma, North Carolina and the permanent bank building for New East Bank of Goldsboro as well as costs associated with other capital expenditures at the Bank level; and deposit and other insurance ($ 21,814 or 44 percent increase) due primarily to increases in FDIC premiums and the growth of the deposit base being insured.

Currently, the Holding Company's only source of revenue is fees for services performed for the Banks. During 1992 and 1991, the Holding Company received support service fees from the Banks which helped offset operating expenses incurred. During first quarter 1992, the Holding Company received $ 411,718 of service fees from the Banks. The Holding Company's first quarter 1991 results of operations included service fee revenues of $ 357,505. Operating expenses of the Holding Company totalled $ 586,056 for first quarter 1992 and $ 526,813 in 1991. The 1992 expenses were comprised of $ 348,973 of personnel expense, $ 112,807 of occupancy and equipment expense, $ 31,669 of travel, administrative support and training expense and $ 92,607 of other general and administrative expense. Operating expenses in 1991 were comprised of $ 299,135 of personnel expense, $ 91,217 of occupancy and equipment expense and $ 136,461 of other general and administrative expense.

Losses from operations of the Banks decreased in first quarter 1992 from 1991 primarily because of the continued growth of the Banks and the impact of nonrecurring gains from the sales of investment securities. During 1991, four of the

Banks were in operation for the entire year and the fifth Bank, New East Bank of New Bern, opened in June. Losses from new bank operations are expected because it typically takes several years for a bank to grow to an asset size sufficient to cover its costs of operations. Generally the Banks' losses are declining on a month-to-month basis due to increasingly higher volumes of earning assets that contribute more net interest income to offset noninterest expenses.

## Interest-earning Assets

Loans, which comprise 75 percent of earning assets, grew to $ 90,483,998 at March 31, 1992 from $ 77,932,899 at December 31, 1991. The loan portfolio is diversified and does not include any significant concentrations in one industry or borrower relationship. Approximately 60 percent of the loans in the portfolio are floating rate loans. The yield on average loans outstanding was 9.68 percent for the first quarter of 1992 compared to 10.2 percent during the same period in 1991. The decrease in the yield on loans has been experienced by all financial institutions as interest rates have declined significantly since the same period in the prior year.

The investment portfolio totalled $ 22,184,277 at March 31, 1992 compared to $ 26,356,403 at December 31, 1991. Investment securities were approximately 16 percent of total consolidated assets in 1992 and 21 percent at year-end 1991. These assets earned on the average 8.61 percent and 10.2 percent in 1992 and 1991, respectively. All investment securities are in U. S. Treasury securities, U. S. Government agencies and corporations, mortgage-backed securities or collateralized mortgage obligations. At March 31, 1992, the market value of the portfolio exceeded its amortized cost by $ 470,178.

## Allowance for Loan Losses

The Corporation maintains a loan loss allowance of $ 1,422,000 as of March 31, 1992 compared to an allowance of $ 1,264,526 as of December 31, 1991. The allowance for loan losses as a percent of loans outstanding at March 31, 1992 was 1.57 percent, compared to 1.62 percent at the end of 1991. Based on information currently available to management, the allowance for loan losses is believed to be adequate. However, future additions to the allowance may be necessary based on changes in economic conditions or the circumstances of individual borrowers which may impact borrowers' ability to repay their loans. Management believes its policies of monitoring loans and its lending practices will minimize any adverse consequences of an extended sluggish economy.

## Interest-bearing Liabilities

While the percentage of core deposits to total deposits outstanding decreased in 1991, the majority of the interest-bearing liabilities are core deposits (75 percent of interest-bearing deposits outstanding at March 31, 1992). Time deposits over $ 100,000 totalled approximately $ 28,235,000 at March 31,1992. Many of the deposits over $ 100,000 are from directors of the Corporation or Banks. The average cost of funds for interest-bearing deposits was 5.76 percent in first quarter 1992 and 7.13 percent in the same period in 1991.

Securities sold under repurchase agreements averaged $ 610,549 in 1992 with a cost of funds of 4.3 percent.

## Net Interest Income

The principal source of the Banks' earnings is net interest income which is the excess of income generated from interest-earning assets over the interest costs of the funds obtained to carry them. Net interest income increased from $ 608,605 to $ 1,092,011 in 1992 due to the continued growth of the Banks. Net yield on average earning assets increased from 3.14 percent in first quarter 1991 to 4.31 percent in 1992 due to the restructuring of earning assets from federal funds sold and investment securities to higher-yielding loans. The average rate earned on earning assets was 9.24 percent in 1992 and the average rate paid on interest-bearing liabilities was 5.62 percent.

### Effects of Current Economic Conditions

The economy has been sluggish from late 1989 through the present. The general economic softness has been compounded by the Middle East conflict, banking and thrift industry problems and a nationwide slowdown in real estate markets. Although the Corporation and the Banks have not experienced any material effects from these events, continued adverse economic conditions or a prolonged, significant downturn in the economy of eastern North Carolina could limit the Banks' growth.

Two of the Banks, New East Bank of Goldsboro and New East Bank of the Cape Fear are based in markets where significant numbers of military personnel were deployed in early 1991 as part of Operation Desert Storm which intensified the general economic downturn in these local markets. With the return of the troops, the economy in those markets significantly improved. Neither of the Banks has any direct concentration of business with military personnel or related businesses, although some indirect impact was felt through businesses that depend on the military as their customer base. Future reduction of troops or closing of those military bases would have a significant negative impact on the markets in which those Banks operate.

### Effects of Current Regulatory Recommendations

Various proposals are pending in Congress that could materially affect the banking industry, including proposals to change the deposit insurance system, expand the powers of financial institutions and reconstitute the bank regulatory system. Because these proposals are in early stages of consideration, management cannot assess the impact any of these proposals are likely to have on the operations of the Corporation or the Banks. It is anticipated that the Banks' cost of deposit insurance with the Federal Deposit Insurance Corporation (the "FDIC") will continue to increase. During the second half of 1991, the premium rate was 0.23 percent of total deposits. The FDIC is considering an increase of the rate to 0.30 percent of total deposits by mid-1992.

The 1991 Act provides for risk-based assessments of insurance premiums beginning with the earlier of January 1, 1994 or 180 days after the final regulations setting out the risk-based assessment parameters become effective. Under the risk-based system, a bank's semi-annual assessment will be based on (i) the probability that the Bank Insurance Fund will incur a loss with respect to the institution, taking into consideration the risks attributable to (a) different categories and concentrations of assets, (b) different categories and concentrations of liabilities, and (c) any other factors the FDIC deems relevant; (ii) the likely amount of any such loss; and (iii) the revenue needs of the Bank Insurance Fund. Management cannot at this time determine the effect that the 1991 Act will have on the Banks' deposit insurance premiums but anticipates that such premiums will continue to increase and be an increasingly material expense for the Banks.

## Current Accounting Issues

The Financial Accounting Standards Board (FASB) has issued Statement No. 109, "Accounting for Income Taxes" which supersedes Statement No. 96. The statement requires that deferred taxes be adjusted for the effects of changes in the tax laws or tax rates. It also requires an asset and liability approach to financial accounting and reporting of income taxes. Management plans to adopt this statement on a prospective basis and expects an immaterial effect on earnings. The statement will be effective in January 1993.

FASB issued Statement No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," during the fourth quarter of 1990. The new Statement primarily covers accounting for retiree health benefits but will also apply to other retiree welfare benefits, such as life insurance. The statement will be effective for fiscal years beginning after December 15, 1992. However, management expects the effect on the Corporation from implementation of this statement to be immaterial to the results of operations.

## Effects of Inflation on Operations

Because the Corporation operates as a financial institution, the majority of its assets and liabilities are monetary in nature and, therefore, differ greatly from those of most industrial or commercial companies that have significant investments in fixed assets. Due to this fact, the effects of inflation on the Corporation's balance sheet will be minimal, meaning that there will be no substantial increases or decreases in the net purchasing power over time. The most significant effect of inflation will be on noninterest expenses which tend to rise during periods of general inflation.

## NEW EAST BANCORP
### Average balance sheet and net interest income
Three months ended March 31, 1992

| | Average Balance | Interest Income/ Expense | Average Yield/ Rate |
|---|---|---|---|
| **Earning assets:** | | | |
| Loans | $ 74,275,807 | 1,798,108 | 9.68% |
| Federal funds sold | 4,392,362 | 54,480 | 4.96% |
| Investment securities | 22,755,619 | 489,870 | 8.61% |
| Securities purchased under agreements to resell and loan participations | - | - | - |
| Total earning assets | 101,423,788 | 2,342,458 | 9.24% |
| **Non-earning assets:** | | | |
| Cash and due from banks | 5,078,122 | | |
| Premises and equipment | 8,105,328 | | |
| Other assets | 102,062 | | |
| **Total assets** | $ 114,709,300 | | |
| **Interest-bearing liabilities:** | | | |
| Savings and time deposits | 86,032,902 | 1,237,837 | 5.76% |
| Securities sold under agreements to repurchase and fed funds purchased | 610,649 | 6,570 | 4.30% |
| Notes payable and capital lease obligations | 2,981,791 | 6,040 | 0.81% (I) |
| Total interest-bearing liabilities | 89,014,693 | 1,250,447 | 5.62% |
| **Noninterest-bearing liabilities:** | | | |
| Demand deposits | 9,302,416 | | |
| Other liabilities | 1,123,224 | | |
| Shareholders' equity | 14,053,669 | | |
| **Total liabilities and equity** | $ 113,494,002 | | |
| Net interest income and net yield on earning assets | | 1,092,011 | 4.31% |

(I) Interest expense of $ 41,084 was capitalized during the period.

# NEW EAST BANCORP

## Average balance sheet and net interest income
## Three months ended March 31, 1991

| | | Average Balance | Interest Income/ Expense | Average Yield/ Rate |
|---|---|---|---|---|
| **Earning assets:** | | | | |
| Loans | $ | 47,130,126 | 1,201,753 | 10.20% |
| Federal funds sold | | 9,891,111 | 153,152 | 6.19% |
| Investment securities | | 18,555,948 | 385,513 | 8.31% |
| Securities purchased under agreement to resell and loan participations | | 2,044,778 | 32,124 | 6.28% |
| Total earning assets | | 77,621,963 | 1,772,542 | 9.13% |
| **Non-earning assets:** | | | | |
| Cash and due from banks | | 3,762,253 | | |
| Premises and equipment | | 5,833,308 | | |
| Other assets | | 1,883,255 | | |
| **Total assets** | $ | 89,100,799 | | |
| **Interest-bearing liabilities:** | | | | |
| Savings and time deposits | | 63,136,138 | 1,125,106 | 7.13% |
| Notes payable and Capital lease obligations | | 4,248,617 | 37,831 | 3.56% |
| Total interest bearing liabilities | | 67,384,755 | 1,163,937 | 6.91% |
| **Non interest-bearing liabilities:** | | | | |
| Demand deposits | | 5,428,448 | | |
| Other liabilities | | 1,446,004 | | |
| Shareholders' equity | | 14,841,592 | | |
| **Total liabilities and equity** | $ | 89,100,799 | | |
| Net interest income and net yield on earning assets | | | 608,605 | 3.14% |

## PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

The Company is not involved in any material pending legal proceedings.

Item 2. Changes in securities.

None.

Item 3. Default Upon Senior Securities.

Not applicable.

Item 4. Submission of Matters to a Vote of Securities Holders.

None.

Item 5. Other information.

Not applicable.

Item 6. Exhibits and Reports on Form 8-K.

a) Previously reported.

b) None.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**New East Bancorp**

Date: May 13, 1992

William H. Olive, Jr.
Chairman and CEO

Date : May 13, 1992

Naudain L. Machen
Vice President and
Controller

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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

## FORM 10-Q

(Mark One)

[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended **MARCH 31, 1992,**

or

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ____ to ____

Commission file number: 0-19094

## OESI POWER CORPORATION

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 88-0225176 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

4000 Kruse Way Place
Building One, Suite 255
Lake Oswego, Oregon
(Address of principal executive offices)

97035
(Zip Code)

**PROCESSED BY**
MAY 22 1992
17/17 P
Microfilmed by
Q-Data Corp. - St. Petersburg, FL
L SQ

(503) 636-9620
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No__

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding at May 8, 1992 |
|---|---|
| Common Stock, $.01 par value | 6,402,185 shares |

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# OESI POWER CORPORATION AND SUBSIDIARIES

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Coopers
&Lybrand

certified public accountants

555 Capitol Mall
Sacramento, California 95814

telephone (916) 441-4334
facsimile (916) 444-8988

in principal areas of the world

To the Board of Directors and Stockholders
OESI Power Corporation and Subsidiaries
4000 Kruse Way Place
Lake Oswego, OR 97035

We have made a review of the consolidated balance sheet of OESI Power Corporation and Subsidiaries as of March 31, 1992, and the statements of income and cash flows for the three months ended March 31, 1992 and 1991 in accordance with standards established by the American Institute of Certified Public Accountants.

A review of interim financial information consists principally of obtaining an understanding of the system for the preparation of interim financial information, applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements for them to be in conformity with generally accepted accounting principles.

Coopers + Lybrand

Sacramento, California
May 19, 1992

## OESI POWER CORPORATION AND SUBSIDIARIES
## CONSOLIDATED BALANCE SHEETS
(dollars in thousands)

| | March 31, 1992 (unaudited) | December 31, 1991 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 708 | $ 1,155 |
| Restricted cash | 3,088 | 3,127 |
| Accounts and other receivables, net | 4,482 | 4,793 |
| Inventory | 1,630 | 1,630 |
| Due from affiliates | 2,801 | 2,854 |
| Construction in progress | 70,206 | 69,430 |
| Notes receivable from affiliates, current portion | 2,522 | 2,499 |
| Recoverable income taxes | 2,176 | 2,176 |
| Other | 1,382 | 752 |
| Total current assets | 88,995 | 88,416 |
| Notes receivable from affiliates, net of current portion | 14,966 | 14,966 |
| Notes receivable, net of current portion | 306 | 306 |
| Due from affiliates | 4,818 | 4,818 |
| Property, plant and equipment, net | 128,204 | 128,634 |
| Deposits and investments | 2,292 | 2,179 |
| Restricted cash | 1,855 | 1,274 |
| Other | 2,968 | 2,982 |
| | $ 244,404 | $243,575 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $ 13,259 | $ 16,568 |
| Due to affiliates | 8,427 | 8,828 |
| Notes payable to affiliates, current portion | 1,420 | 670 |
| Notes payable, current portion | 65,249 | 60,171 |
| Direct financing leases, current portion | 803 | 803 |
| Total current liabilities | 89,158 | 87,040 |
| Due to affiliates | 3,350 | 3,350 |
| Deferred income taxes | 2,669 | 2,669 |
| Notes payable to affiliates, net of current portion | 17,678 | 17,643 |
| Notes payable, net of current portion | 327 | 310 |
| Direct financing leases, net of current portion | 75,445 | 75,445 |
| Total liabilities | 188,627 | 186,457 |
| Deferred income | 5,011 | 5,045 |
| Commitments and contingencies (Note 3). | | |
| Redeemable preferred stock | 15,800 | 15,800 |
| Common stockholders' equity: | | |
| Common stock: $.01 par value, 15,000,000 shares authorized, 6,402,185 shares issued and outstanding at March 31, 1992 and December 31, 1991 | 64 | 64 |
| Additional paid-in capital | 32,661 | 32,661 |
| Retained earnings | 2,241 | 3,548 |
| Total common stockholders' equity | 34,966 | 36,273 |
| | $ 244,404 | $243,575 |

The accompanying notes are an integral part of these financial statements.

## OESI POWER CORPORATION AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF INCOME
(dollars in thousands, except per share amounts)

| | Three Months Ended March 31, | |
|---|---|---|
| | 1992 | 1991 (restated) |
| | (unaudited) | |
| **Revenues:** | | |
| **Development:** | | |
| **Affiliates** | $ 14 | $ 772 |
| **Operations:** | | |
| **Affiliates** | 630 | 2,307 |
| **Other** | 4,198 | 3,231 |
| | 4,828 | 5,538 |
| **Interest income:** | | |
| **Affiliates** | 142 | 550 |
| **Other** | 91 | 143 |
| | 233 | 693 |
| **Total revenues** | 5,075 | 7,003 |
| **Costs and expenses:** | | |
| **Operations** | 3,604 | 4,583 |
| **Marketing and administration** | 1,031 | 394 |
| **Interest** | 1,203 | 659 |
| **Depreciation and amortization** | 1,347 | 912 |
| **Total costs and expenses** | 7,185 | 6,548 |
| **Income (loss) before income taxes and cumulative effect of change in accounting principle** | (2,110) | 455 |
| **Benefit from (provision for) income taxes** | 802 | (173) |
| **Income (loss) before cumulative effect of change in accounting principle** | (1,308) | 282 |
| **Cumulative effect of change in accounting for income taxes** | — | 300 |
| **Net income (loss)** | (1,308) | 582 |
| **Less preferred dividend requirements** | 237 | 235 |
| **Earnings (loss) applicable to common stock** | $ (1,545) | $ 347 |
| **Earnings (loss) per common and common equivalent share** | $ (.24) | $ .08 |
| **Weighted average common and common equivalent shares outstanding** | 6,402,185 | 4,310,572 |

The accompanying notes are an integral part of these financial statements.

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# OESI POWER CORPORATION AND SUBSIDIARIES
# CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

| | Three Months Ended March 31, 1992 (unaudited) | Three Months Ended March 31, 1991 (restated) (unaudited) |
|---|---|---|
| Cash flows from operating activities: | | |
| Income (loss) before cumulative effect of change in accounting principle | $ (1,308) | $ 282 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Cumulative effect of change in accounting principle | — | 300 |
| Depreciation and amortization | 1,347 | 912 |
| Amortization of deferred income | 35 | 627 |
| Deferred income taxes | — | (300) |
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in restricted cash | (541) | 980 |
| Decrease in accounts and other receivables | 311 | 44 |
| Decrease in inventory | — | 433 |
| Decrease in due from affiliates | 53 | 631 |
| Increase in construction in progress | (775) | (16,299) |
| (Increase) decrease in deposits and investments | (113) | 1,336 |
| (Increase) decrease in other assets | (615) | 861 |
| Decrease in accounts payable and accrued expenses | (3,305) | (2,672) |
| Decrease in due to affiliates | (402) | (2,653) |
| Net cash used in operating activities | (5,313) | (15,518) |
| Cash flows from investing activities: | | |
| Purchase of property, plant and equipment | (1,015) | (1,864) |
| Collection of notes receivable | — | 2,912 |
| Net cash provided by (used in) investing activities | (1,015) | 1,048 |
| Cash flows from financing activities: | | |
| Proceeds from issuance of debt | 7,416 | 15,299 |
| Repayment of debt | (1,535) | (1,072) |
| Dividends paid | — | (330) |
| Net cash provided by financing activities | 5,881 | 13,897 |
| Net decrease in cash and cash equivalents | (447) | (573) |
| Cash and cash equivalents at beginning of period | 1,155 | 2,223 |
| Cash and cash equivalents at end of period | $ 708 | $ 1,650 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid during period for: | | |
| Interest, net of amounts capitalized | $ 756 | $ 225 |
| Income taxes | $ — | $ 1,399 |

The accompanying notes are an integral part of these financial statements.

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## OESI POWER CORPORATION AND SUBSIDIARIES
## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1. MANAGEMENT'S STATEMENT

In the opinion of Company management, the accompanying unaudited financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position and results of operations for the periods shown. These financial statements should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 1991.

Certain reclassifications have been made to the December 31, 1991 amounts for comparative purposes, but these have not affected previously reported net income or retained earnings.

The results of operations for the three-month period ended March 31, 1992 are not necessarily indicative of the results to be expected for the full year.

### NOTE 2. COMPUTATION OF EARNINGS PER SHARE

Earnings per common and common equivalent share are computed using the weighted average number of common and common equivalent shares outstanding during the period. Common equivalent shares consist of stock options, which are excluded from the computation if antidilutive. Fully diluted earnings per share did not differ significantly from primary earnings per share in any period.

### NOTE 3. CONTINGENCIES

#### UNCERTAINTIES:

#### Puna Project

In June 1991, drilling was suspended and drilling permits withdrawn on the Puna project as a result of an uncontrolled flow during drilling of a geothermal well. Although the well was controlled within days, the project has been significantly delayed awaiting the return of the permits. In October 1991, non-drilling related permits were reinstated allowing construction, other than drilling, to continue. On February 28, 1992, the drilling permits were reinstated, and PGV immediately commenced remedial work needed for completion of the well and its testing.

On April 21, 1992, the Third Circuit Court of the State of Hawaii, in response to a lack of rules promulgated by the Hawaii Department of Health ("DOH") regarding certain types of emissions, entered an order staying Puna Geothermal Venture ("PGV") from conducting any activities which would emit hydrogen sulfide into the atmosphere, except safety and remedial measures. The stay order remains in effect until at least May 29, 1992, when another hearing in the case is scheduled. PGV has appealed the decision to the State of Hawaii Supreme Court. The DOH is expected to promulgate regulations governing hydrogen sulfide emissions in June 1992. These regulations should resolve the issues which led to the stay order, and thereby allow PGV to apply for a new permit which, if granted, would allow PGV to resume drilling activities.

In the meantime, the stay order prohibits PGV from conducting the drilling activities necessary to complete the Puna I plant and place it in service. The Company's partner in the project is funding

PGV's cash requirements during the delay.

PGV has a construction loan for the Puna I project from a syndicate of banks for $100 million, which was due January 31, 1992. PGV had drawn $93.4 million as of August 1991. At that time, the lender suspended advances under the loan until the drilling permits for the project were fully reinstated and other conditions were met. As a result of these project completion delays, certain milestone dates outlined in the project's construction financing agreement were not met, thus causing loan provision default. The lenders have not exercised their remedies under the loan agreement and have indicated a willingness to extend the applicable contract dates. Project management is currently negotiating extensions to the construction loan maturity and equity contribution dates and has requested an extension to December 31, 1992, to enable PGV to successfully complete and sell the project. Although the construction loan is secured by the assets of the Puna I project, the loan agreement obligates the Company to fund up to 15% of the principal outstanding (a maximum of $15 million) as additional equity for the project under certain circumstances, which could include the maturing of the principal obligation. Such amount is guaranteed by LFC Financial Corp, a principal stockholder and affiliate of the Company.

The Company's partner in PGV has made certain advances to the Company to cover the Company's share of the Puna I project construction costs. These interest-bearing advances totalled $3.9 million at March 31, 1992. The Company has pledged its stock in two subsidiaries which hold its equity interest in PGV to its partner to secure these advances. Because the advances have not been repaid as scheduled, the Company's partner now has remedies available which may include the right to foreclose on the pledged stock. The Company is currently negotiating with its partner for modification of terms and extension of payment. If the Company fails to satisfactorily conclude negotiations with its partner or make other arrangements for settlement of the advances, and its partner then elects to foreclose on the pledged stock, the Company will lose its equity interest in the Puna I project. Such a foreclosure would have a material adverse effect on results of operations for 1992 and on stockholders' equity.

In a letter dated March 5, 1992, Hawaii Electric Light Company, Inc. informed PGV of its imposition of monetary sanctions pursuant to a related purchase power contract (the "Contract") for non-delivery of electrical capacity. PGV management maintains that the sanctions are without cause because the delay in the delivery of contracted capacity is due to force majeure events as defined in the Contract. If the dispute cannot be resolved by mutual agreement, the Contract provides for arbitration by the Hawaii Public Utilities Commission or by appropriate legal action. The alleged amounts of the sanctions are approximately $2.7 million through mid-May 1992 plus $350,000 monthly until electricity is delivered. Any amounts for sanctions ultimately payable can be satisfied by offset against power sales revenue.

Soda Lake Project

Soda Lake Resources Partnership, in which the Company holds an interest, and Soda Lake Limited Partnership, the lessor of the Soda Lake plant, have experienced a delay in converting construction loans to permanent financing. The lender has issued notices of default but has not made demand for payment or exercised other remedies under the loan agreements. A standstill agreement is being negotiated which would be effective through June 22, 1992. If the current lender extends term financing for the project, such financing may be approximately $11.3 million less than originally anticipated. If term financing is reduced, the lease agreements contain provisions that require a corresponding reduction in lease payments. Accordingly, because the lessor's financing may be reduced, the Company's receivable of $11.3 million related to the construction of this facility may be considered an additional investment in the facility which should be recoverable through lower lease rentals paid by the Company over the term of the lease. The Company is currently attempting to obtain long-term financing at the original level from another source. There is no assurance that such financing can be obtained.

It is not possible to determine the ultimate outcome of the uncertainties associated with the Puna and Soda Lake projects with any degree of certainty or the range of potential costs that may be involved. Accordingly, no provision for any liability or loss that may result from resolutions of these uncertainties has been made in the accompanying consolidated financial statements.

### OTHER LITIGATION:

The Company is a defendant in other legal proceedings arising in the ordinary course of business. Although the amount of ultimate exposure, if any, cannot be determined at this time, based on facts available, management does not expect the final outcome of these matters to have a material adverse effect on the Company's financial position.

## NOTE 4. INCOME TAXES

Effective January 1, 1991, the Company has retroactively adopted Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes," which requires an asset and liability approach in accounting for income taxes. Under the new accounting method, deferred tax liabilities and assets are recognized for the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized. A current tax liability or asset is recognized for the estimated taxes payable or refundable on tax returns for the current year. The cumulative effect, as of January, 1, 1991, of this change in accounting principle amounted to $300,000 and $.07 per share for the quarter ended March 31, 1991. The financial statements at March 31, 1991 have been restated to reflect the cumulative effect of this change.

## NOTE 5. NOTES PAYABLE

In January 1992, the Company entered into a revolving credit agreement with a major domestic bank to provide funds for project development, equity investments in new or existing projects and for general corporate purposes. There is a maximum amount of $25 million potentially available to the Company under the agreement; amounts available for borrowing under the agreement are limited by a borrowing base formula which is tied to cash flows from completed geothermal projects. The Company initially borrowed $5.7 million under the agreement. In May 1992, the Ormesa IE plant entered the borrowing base and the Company borrowed an additional $2 million. The funds were used for repayment of debt and working capital. The Company is currently not in compliance with certain of the credit agreement covenants. As a result, the lender has remedies under which it may make all borrowings immediately due and payable and may use certain pledged revenues of the Company to satisfy the debt. The Company is currently negotiating a waiver of these covenants with the lender. Accordingly, these borrowings, which would otherwise be classified as long-term debt, are reflected as current liabilities in the March 31, 1992 balance sheet.

## NOTE 6. SUBSEQUENT EVENTS

The Company has outstanding borrowings of $1.7 million from a bank. Under the terms of the loan agreement, a repayment of $1 million was due on May 18, 1992. Such payment was not made while the Company is negotiating repayment terms with the lender.

On May 15, 1992, the Company received default notifications from the Stillwater project lender as a result of certain liens being filed against the project. The liens were initiated by vendors who performed work for the Company at the Stillwater facility. The project lender, who is also the lender for the Ormesa IE Expansion project, had agreed that the Stillwater work was to be paid from the closing and funding of the Ormesa IE Expansion project. However, the lender has not been willing to fund the Ormesa IE Expansion project and, as a result, the Stillwater vendors have not been paid. The Company cannot predict the ultimate outcome of this issue.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### RESULTS OF OPERATIONS

### REVENUES

Development and operations revenues for the three-month periods ended March 31, 1992 and 1991, were comprised of (dollars in thousands):

| | Three Months Ended March 31, | |
|---|---|---|
| | 1992 | 1991 |
| **Development Revenues**: | | |
| Puna I | $ — | $ 662 |
| Amortization of deferred revenue | 34 | 110 |
| Other | (20) | — |
| | $ 14 | $ 772 |
| **Operations Revenues**: | | |
| Sales of electricity | $ 4,187 | $ 2,708 |
| Fluid sales | 253 | 972 |
| Operating services | 72 | 84 |
| Warranty revenues | — | 1,079 |
| Parts sales | — | 485 |
| Other | 316 | 210 |
| | $ 4,828 | $ 5,538 |

Sales of electricity for the three months ended March 31, 1992 increased over the comparable period of 1991 principally as a result of increased sales from the Soda Lake plant, where Soda Lake 2 was placed in commercial operation in August 1991.

Fluid sales decreased for the quarter ended March 31, 1992 from the comparable quarter in 1991 as the result of a decrease in the fluid fees recognized for the Ormesa IE and IH plants. Although the Company continues to supply fluid to these facilities, and the facilities are obligated for payment, revenue may be deferred and recognized based on available cash flows as defined in the agreements.

Certain non-recurring warranty and parts sales revenues were recorded in the first quarter of 1991. These transactions have associated costs recorded in operations expense, so they have no significant effect on income before taxes.

## COSTS AND EXPENSES

Operations expenses decreased in the three-month period ended March 31, 1992 from the comparable period of 1991 primarily as a result of the Company incurring certain warranty and parts costs in 1991 which were not incurred in 1992. See "Revenues" above for a discussion of warranty and parts transactions in 1991. This decrease was partially offset by an increase in operating and maintenance costs for the Soda Lake facility, where Soda Lake 2 was placed in commercial operation in August 1991.

Marketing and administration expenses increased in 1992 over 1991 principally due to the costs associated with the move to Portland Oregon and the Company's acquisition of a 20% interest in LFC Power Systems Corporation in 1991. Overhead expenses are expected to decrease in the second half of 1992 because the Sparks Nevada office will be closed and several positions will be eliminated. Additional outside services expenses, primarily related to the cost of doing business as a public company, also contributed to the increase in marketing and administration expenses in 1992.

Interest expense increased in the quarter ended March 31, 1992 over the comparable quarter in 1991 as the result of a decrease in the amount of interest capitalized. This reflects the decline in the level of development and construction activity from 1991 to 1992.

Depreciation and amortization expense increased in the first quarter of 1992 over the comparable quarter of 1991 as a result of placing the Soda Lake 2 plant and field in commercial operation in August 1991.

## LIQUIDITY AND CAPITAL RESOURCES

As described below, certain issues have caused delays in the scheduled completion of two projects. Because of these project delays, the Company is not in compliance with the repayment terms of certain construction and other project financing agreements, its revolving credit agreement and a bank loan agreement. In addition, certain lawsuits, claims and assertions related to one of these projects have been brought against the Company and may cause further project completion delays, asset impairment or additional liabilities. See ITEM 1 – "LEGAL PROCEEDINGS." At this time the Company cannot predict the ultimate effect, if any, that may result from an adverse outcome of any of these issues. Accordingly, no provision for any liability or loss that may result from a resolution of these delays and contingencies has been made in the accompanying consolidated financial statements.

On April 21, 1992, the Third Circuit Court of the State of Hawaii, in response to a lack of rules promulgated by the Hawaii Department of Health ("DOH") regarding certain types of emissions, entered an order staying Puna Geothermal Venture ("PGV") from conducting any activities which would emit hydrogen sulfide into the atmosphere, except safety and remedial measures. The stay order remains in effect until at least May 29, 1992, when another hearing in the case is scheduled. PGV has appealed the decision to the State of Hawaii Supreme Court. The DOH is expected to promulgate regulations governing hydrogen sulfide emissions in June 1992. These regulations should resolve the issues which led to the stay order, and thereby allow PGV to apply for a new permit which, if granted, would allow PGV to resume drilling activities.

In the meantime, the stay order prohibits PGV from conducting the drilling activities necessary to complete the Puna I plant and place it in service. The Company's partner in the project is funding

PGV's cash requirements during the delay.

PGV has a construction loan for the Puna I project from a syndicate of banks for $100 million, which was due January 31, 1992. PGV had drawn $93.4 million as of August 1991. At that time, the lender suspended advances under the loan until the drilling permits for the project were fully reinstated and other conditions were met. As a result of these project completion delays, certain milestone dates outlined in the project's construction financing agreement were not met, thus causing loan provision default. The lenders have not exercised their remedies under the loan agreement and have indicated a willingness to extend the applicable contract dates. Project management is currently negotiating extensions to the construction loan maturity and equity contribution dates and has requested an extension to December 31, 1992, to enable PGV to successfully complete and sell the project. Although the construction loan is secured by the assets of the Puna I project, the loan agreement obligates the Company to fund up to 15% of the principal outstanding (a maximum of $15 million) as additional equity for the project under certain circumstances, which could include the maturing of the principal obligation. Such amount is guaranteed by LFC Financial Corp, a principal stockholder and affiliate of the Company.

The Company's partner in PGV has made certain advances to the Company to cover the Company's share of construction costs. These interest-bearing advances totalled $3.9 million at March 31, 1992. The Company has pledged its stock in two subsidiaries which hold its equity interest in PGV to its partner to secure these advances. Because the advances have not been repaid as scheduled, the Company's partner now has remedies available which may include the right to foreclose on the pledged stock. The Company is currently negotiating with its partner for modification of terms and extension of payment. If the Company fails to satisfactorily conclude negotiations with its partner or make other arrangements for settlement of the advances, and its partner then elects to foreclose on the pledged stock, the Company will lose its equity interest in the PGV project. Such a foreclosure would have a material adverse effect on results of operations for 1992 and on stockholders' equity.

In a letter dated March 5, 1992, Hawaii Electric Light Company, Inc. informed PGV of its imposition of monetary sanctions pursuant to a related purchase power contract (the "Contract") for non-delivery of electrical capacity. PGV management maintains that the sanctions are without cause because the delay in the delivery of contracted capacity is due to force majeure events as defined in the Contract. If the dispute cannot be resolved by mutual agreement, the Contract provides for arbitration by the Hawaii Public Utilities Commission or by appropriate legal action. The alleged amounts of the sanctions are approximately $2.7 million through mid-May 1992 plus $350,000 monthly until electricity is delivered. Any amounts for sanctions ultimately payable can be satisfied by offset against power sales revenue.

Soda Lake Resources Partnership, in which the Company holds an interest, and Soda Lake Limited Partnership, the lessor of the Soda Lake plant, have experienced a delay in converting construction loans to permanent financing. The lender has issued a notice of default but has not made demand for payment or exercised other remedies under the loan agreements. A standstill agreement is being negotiated which would be effective through June 22, 1992. If the current lender extends term financing for the project, such financing may be approximately $11.3 million less than originally anticipated. If term financing is reduced, the lease agreements contain provisions that require a corresponding reduction in lease payments. Accordingly, because the lessor's financing may be reduced, the Company's receivable of $11.3 million related to the construction of this facility may be considered an additional investment in the facility which should be recoverable through lower lease rentals paid by the Company over the term of the lease. The Company is currently attempting to obtain long-term financing at the original level from another source. There is no assurance that such financing can be obtained.

In January 1992, the Company entered into a revolving credit agreement with a major domestic bank to provide funds for project development, equity investments in new or existing projects and for general corporate purposes. There is a maximum amount of $25 million potentially available to the Company under the agreement; amounts available for borrowing under the agreement are limited by a borrowing base formula which is tied to cash flows from completed geothermal projects. The Company initially borrowed $5.7 million under the agreement. In May 1992, the Ormesa IE plant entered the borrowing base and the Company borrowed an additional $2 million. The funds were used for repayment of debt and working capital. The Company is currently not in compliance with certain of the credit agreement covenants. As a result, the lender has remedies under which it may make all borrowings immediately due and payable and may use certain pledged revenues of the Company to satisfy the debt. The Company is currently negotiating a waiver of these covenants with the lender.

The Company has outstanding borrowings of $1.75 million from a bank. Under the terms of the loan agreement, a repayment of $1 million was due on May 18, 1992. Such payment was not made while the Company is negotiating repayment terms with the lender.

On May 15, 1992, the Company received default notification from the Stillwater project lender as a result of certain liens being filed against the project. The liens were initiated by vendors who performed work for the Company at the Stillwater facility. The project lender, who is also the lender for the Ormesa IE Expansion project, had agreed that the Stillwater work was to be paid from the closing and funding of the Ormesa IE Expansion project. However, the lender has not been willing to fund the Ormesa IE Expansion project and, as a result, the Stillwater vendors have not been paid. The Company cannot predict the ultimate outcome of this issue.

## PART II

### ITEM 1. LEGAL PROCEEDINGS

Puna Geothermal Venture ("PGV"), a partnership in which subsidiaries of the Company are partners, is a defendant in a suit brought by the Pele Defense Fund ("PDF") and certain individuals challenging the Authority to Construct ("ATC") permits issued to PGV by the State of Hawaii Department of Health (the "DOH") in connection with the development of the geothermal field and construction of the Puna I power plant. A suit was filed March 7, 1990 in the Third Circuit Court for the State of Hawaii, alleging that the DOH issued the permits in violation of the state's laws on air pollution controls, the DOH air pollution regulations and the constitutional rights of the plaintiffs. The plaintiffs asked that the permits be declared null and void and any further activity under the permits be enjoined. This case had not been actively pursued by the plaintiffs until March 1992. On March 18, 1992, the state Supreme Court ruled in a case involving the DOH's issuance of an ATC permit to another geothermal company that, because of the absence of DOH rules regarding certain types of emissions, the ATC permits should not have been issued for this other project. In that case, the Court also requested the DOH to promulgate permanent regulations governing certain stated emissions. Subsequently, the plaintiffs to the PGV lawsuit requested the Circuit Court on March 27, 1992 to enjoin PGV by filing a Temporary Restraining Order ("TRO") and to issue a summary judgment ruling that PGV's ATC permits are null and void. On April 6, 1992, the Court granted the TRO which was subsequently converted to a stay order. The stay order prevents PGV from engaging in any drilling activities which may result in the release of hydrogen sulfide gas into the atmosphere until further order of the Court or until the DOH promulgates the required regulations and PGV obtains a new permit under such regulations. A further hearing on contested issues is scheduled for May 29, 1992. PGV will request at the May 29 hearing that the stay order be lifted.

In the meantime, the DOH has published a notice of its intent to promulgate specific regulations governing hydrogen sulfide. The DOH has indicated that it expects these regulations to correct the alleged deficiency in the ATC permitting process which was addressed in the Supreme Court case. The new rules are expected to become effective in June 1992 and would allow PGV to apply for a new permit. The stay order will automatically terminate upon PGV receiving a permit under the new regulations.

PGV prevailed at the trial court level against motions for preliminary and permanent injunctions and a complaint for declaratory judgment brought by PDF and certain individual plaintiffs in September 1990. The plaintiffs argued that the Puna I facility would violate state noise pollution laws and that certain conditions of the geothermal resource permit (the "GRP") were not complied with. PDF appealed the dismissal of its complaint to the state Supreme Court in December 1990. The case was transferred to the state Intermediate Court of Appeals and on March 31, 1992, the Intermediate Court entered a judgment dismissing with prejudice two of the plaintiffs' three claims, and remanding the third claim for further action. In the third claim, plaintiffs do not attack the validity of the GRP, but instead assert that building permits for the Puna I facility were invalidly issued because of a failure to meet conditions of the GRP. Since construction of the power plant is virtually complete, the Company cannot predict what remedy might be granted in the event of an eventual adverse ruling and, therefore, cannot predict the impact of such a ruling on the project.

## ITEM 5. OTHER INFORMATION

Federal regulations restrict the ownership, among other things, of the Company's facilities by certain electric utilities or electric utility holding companies and affiliates of either, if the facilities are to be considered Qualifying Facilities under the Public Utility Regulatory Policies Act. All the Company's current facilities are, and all its future power projects will be, designed to be Qualifying Facilities or their regulatory equivalent. As a result, the Company's Certificate of Incorporation prohibits ownership of its common stock by certain electric utilities or electric utility holding companies, including affiliates of either, by providing that any attempted sale, transfer, assignment, conveyance or pledge of the Company's common stock to such an entity is void. No transfer to such an entity will be recorded and the entity will not be recognized as a holder of the Company's common stock. The Company will be deemed to be appointed attorney-in-fact for such intended transferor and transferee with full power to sell the affected shares of common stock on behalf of such parties. In addition, the Company's Certificate of Incorporation provides that if a stockholder becomes such an entity, each share held by such stockholder will automatically and immediately convert into nonvoting redeemable preferred stock. Such preferred stock is not entitled to receive dividends and may be redeemed by the Company at the closing sale price on the date such preferred stock comes into existence or is redeemed (whichever is lesser).

## ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits filed with this Form 10-Q:

None

(b) Reports on Form 8-K:

None

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

OESI Power Corporation
(Registrant)

Date: May 19, 1992

By: James W Porter Jr
James W. Porter, Jr.
Chief Executive Officer

Date: May 19, 1992

By: Robert Anderson Jr
Robert C. Anderson, Jr.
Vice President
Chief Financial Officer

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**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C.**

**20549**

# FORM 10-Q

## QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
## OF THE SECURITIES EXCHANGE ACT OF 1934

BEST COPY AVAILABLE

| | |
|---|---|
| For Quarter Ended: | Commission File Number: |
| March 31, 1992 | 0-19334 |

**OUTBACK STEAKHOUSE, INC.**
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **DELAWARE** | **59-3061413** |
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification Number) |

**550 North Reo Street, Suite 204**
**Tampa, FL 33609**
(Address of principal executive offices) (Zip Code)

**(813) 282-1225**
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No ____.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. **As of March 31, 1992, there were 11,424,409 shares of Common Stock, $.01 par value outstanding.**

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## OUTBACK STEAKHOUSE, INC.

## PART I: FINANCIAL INFORMATION

### Item 1. Financial Statements

The accompanying unaudited consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of the Company, all adjustments (consisting only of normal recurring entries) necessary for the fair presentation of the Company's results of operations, financial position and changes therein for the periods presented have been included.

## OUTBACK STEAKHOUSE, INC.
## CONSOLIDATED BALANCE SHEETS

| ASSETS | March 31, 1992 | December 31, 1991 |
|---|---|---|
| | (Unaudited) | |
| CURRENT ASSETS | | |
| Cash | $39,149,400 | $16,232,800 |
| Inventories | 748,500 | 903,900 |
| Other current assets | 751,600 | 634,200 |
| Total current assets | 40,649,500 | 17,770,900 |
| PROPERTY | | |
| Land | 580,800 | 539,900 |
| Furniture and fixtures | 1,732,800 | 1,616,300 |
| Equipment | 6,480,300 | 4,781,100 |
| Leasehold improvements | 6,546,100 | 6,188,600 |
| Construction in progress | 2,067,600 | 348,400 |
| | 17,407,600 | 13,474,300 |
| Less accumulated depreciation and amortization | (1,854,100) | (1,512,200) |
| Total property, net | 15,553,500 | 11,962,100 |
| PRE-OPENING COSTS, NET | 775,000 | 1,072,700 |
| INVESTMENTS IN AND ADVANCES TO UNCONSOLIDATED AFFILIATES | 4,829,200 | 3,774,500 |
| OTHER ASSETS | 132,200 | 134,700 |
| | $61,939,400 | $34,714,900 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| CURRENT LIABILITIES | | |
| Accounts payable | $ 1,352,700 | $ 487,700 |
| Sales taxes payable | 579,000 | 459,800 |
| Accrued expenses: | | |
| Accrued payroll | 540,600 | 764,700 |
| Accrued advertising | 1,439,800 | 728,900 |
| Accrued rent | 143,600 | 257,400 |
| Accrued insurance | 636,400 | 505,300 |
| Other | 440,900 | 289,000 |
| Unearned revenue | 427,900 | 721,600 |
| Current portion of long-term debt | | 240,000 |
| Income taxes payable | 1,581,600 | 1,873,200 |
| Total current liabilities | 7,142,500 | 6,327,600 |
| DEFERRED INCOME TAXES | 310,000 | 300,000 |
| LONG-TERM DEBT | | 746,700 |
| INTEREST OF MINORITY PARTNERS IN CONSOLIDATED PARTNERSHIPS | 699,400 | 692,300 |
| Total liabilities | 8,151,900 | 8,066,600 |
| STOCKHOLDERS' EQUITY | | |
| Preferred stock, $0.01 par value, 2,000,000 shares authorized; none outstanding | | |
| Common stock, $0.01 par value, 20,000,000 shares authorized; 11,424,409 and 10,501,909 shares issued and outstanding as of March 31, 1992 and December 31, 1991, respectively | 114,200 | 105,000 |
| Additional paid-in capital | 44,206,500 | 19,378,800 |
| Retained earnings | 9,466,800 | 7,164,500 |
| Total stockholders' equity | 53,787,500 | 26,648,300 |
| | $61,939,400 | $34,714,900 |

See notes to consolidated financial statements.

# OUTBACK STEAKHOUSE, INC.
# CONSOLIDATED STATEMENTS OF INCOME
# (UNAUDITED)

| | Three Months Ended March 31, 1992 | Three Months Ended March 31, 1991 |
|---|---|---|
| REVENUES | $21,461,300 | $10,519,700 |
| COSTS AND EXPENSES | | |
| Cost of revenues | 8,073,300 | 3,966,100 |
| Restaurant operating expenses | 8,807,300 | 4,345,800 |
| General & administrative expenses | 1,422,300 | 668,800 |
| (Income) from operations of unconsolidated affiliates | (884,700) | (173,000) |
| | 17,418,200 | 8,807,700 |
| INCOME FROM OPERATIONS | 4,043,100 | 1,712,000 |
| NON-OPERATING INCOME (EXPENSE) | | |
| Interest income | 294,700 | 15,200 |
| Interest expense | (18,100) | (48,200) |
| | 276,600 | (33,000) |
| INCOME BEFORE ELIMINATION OF MINORITY PARTNERS' INTEREST AND INCOME TAXES | 4,319,700 | 1,679,000 |
| ELIMINATION OF MINORITY PARTNERS' INTEREST | 541,000 | 212,700 |
| INCOME BEFORE PROVISION FOR INCOME TAXES | 3,778,700 | 1,466,300 |
| PROVISION FOR INCOME TAXES | 1,435,900 | 557,200 (1) |
| NET INCOME | $ 2,342,800 | $ 909,100 (1) |
| EARNINGS PER COMMON SHARE | $ 0.20 | $ 0.10 |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING | 11,596,000 | 9,091,000 |

(1) Amounts include pro forma adjustments for the three months ended March 31, 1991. See page 12 of this report.

See notes to consolidated financial statements.

## OUTBACK STEAKHOUSE, INC.
## CONSOLIDATED STATEMENTS OF CASH FLOWS
## (UNAUDITED)

| | Three Months Ended | |
|---|---|---|
| | March 31, 1992 | March 31, 1991 |
| **Cash flows from operating activities:** | | |
| Net income.................................... | $ 2,342,800 | $ 1,050,400 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation................................. | 341,900 | 184,600 |
| Amortization................................. | 420,000 | 157,900 |
| Outside partners' interest in consolidated partnerships income.......... | 541,000 | 212,700 |
| (Income) from unconsolidated affiliates..................................... | (884,700) | (173,000) |
| Change in assets and liabilities: | | |
| (Increase) decrease in inventories........ | 155,400 | (54,700) |
| Increase in other current assets.......... | (117,400) | (214,500) |
| Increase in pre-opening costs............. | (116,200) | (542,000) |
| (Increase) decrease in other assets....... | (3,600) | 43,900 |
| Increase in accounts payable and accrued expenses......................... | 1,640,200 | 255,100 |
| Decrease in unearned revenue.............. | (293,700) | (95,600) |
| Increase (decrease) in income taxes payable | (291,600) | 203,300 |
| Increase in deferred income taxes......... | 10,000 | 65,100 |
| Net cash provided by operating activities | 3,744,100 | 1,093,200 |
| **Cash flows used in investing activities:** | | |
| Capital expenditures...................... | (3,933,300) | (1,343,700) |
| Payments from unconsolidated affiliates | 878,000 | 284,900 |
| Investments in and advances to unconsolidated affiliates................ | (1,048,000) | (1,418,100) |
| Net cash used in investing activities....... | (4,103,300) | (2,476,900) |
| **Cash flows from financing activities:** | | |
| Proceeds from issuance of stock........... | 24,836,900 | |
| Proceeds from issuance of long-term debt... | | 881,700 |
| Proceeds from minority partners' contributions.......................... | 97,000 | 75,000 |
| Distributions to minority partners and shareholders........................ | (671,400) | (105,000) |
| Repayments of long-term debt.............. | (986,700) | (66,700) |
| Net cash provided by financing activities | 23,275,800 | 784,000 |
| Net increase (decrease) in cash............. | 22,916,600 | (599,700) |
| Cash at beginning of period................ | 16,232,800 | 2,983,000 |
| Cash at end of period...................... | $39,149,400 | $ 2,383,300 |
| **Supplemental disclosures of cash flow information:** | | |
| Cash paid for interest................... | $ 18,000 | $ 39,000 |
| Cash paid for income taxes............... | 1,716,700 | 450,500 |

See notes to consolidated financial statements.

# OUTBACK STEAKHOUSE, INC.
# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
# (UNAUDITED)

## 1. Basis of Presentation

Effective June 25, 1991, the Company and all of the stockholders of Outback Steakhouse, Inc. (a Florida corporation) ("Outback Florida") entered into a reorganization agreement pursuant to which those stockholders exchanged all of their respective shares of Outback Florida Common Stock and Series A, Series B, and Series C Preferred Stock for shares of Common Stock of the Company. The holders of options to purchase Common Stock of Outback Florida agreed to exchange those options for options to purchase shares of Common Stock of the Company. In addition, the Company entered into exchange agreements with substantially all of the limited partners of the nine limited partnerships of which Outback Florida was the sole general partner, providing for the exchange of their limited partnership interests for shares of Common Stock of the Company.

The Exchanges have been accounted for as a combination of entities under common control and the financial statements presented herein have been restated to apply retroactive effect to the transactions referred to above for the applicable periods presented. The balances in each exchanging partners' capital were transferred to the equity account of the reorganized company. The income attributed to the exchanging partners has been treated as if it had been income to the reorganized company.

In December 1991, the Company entered into an Agreement and Plan of Reorganization with American Restaurants, one of the Company's Development Joint Venture partners, providing for the merger of American Restaurants into the Company. The merger was completed in January 1992. The former stockholders of American Restaurants received an aggregate of 510,000 shares of Common Stock of the Company in exchange for all of the outstanding capital stock of American Restaurants. The merger has been accounted for as a combination of entities under common control using historical amounts and the financial statements presented herein have been restated to give retroactive effect to the merger for the applicable periods presented.

For comparative purposes, pro forma statements of income are presented within this report for the three months ended March 31, 1991. In the opinion of management, these statements are necessary for the fair presentation of the operating results for the respective periods. The pro forma adjustments properly reflect the pro forma increase in the provision for income tax of the Company as a result of the exchange and merger described above (see page 12 of this report). Since the Company is not liable for the payment of income taxes attributable to the exchanging partners prior to June 25, 1991 or American Restaurants prior to December 31, 1991, no adjustments to the balance sheets have been made for pro forma taxes.

## Long-term Debt

Long-term debt consisted of the following:

| | March 31, 1992 | December 31, 1991 |
|---|---|---|
| Notes payable to banks, secured by equipment and fixtures, interest at rates ranging from 7.5% to 10%, principal and interest due in 60 monthly installments | | $ 986,700 |
| Less current portion | | 240,000 |
| Long-term Debt | | $ 746,700 |

All of the notes payable outstanding as of December 31, 1991 were assumed by the Company in connection with the merger with American Restaurants. During the quarter ended March 31, 1992, all of the notes were repaid from cash on hand.

## Stockholders' Equity

In January 1992, the Company completed the sale of 900,000 shares of its Common Stock through a public offering. Net proceeds to the Company totaled approximately $24,600,000.

## OUTBACK STEAKHOUSE, INC.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Results of Operations**

The following table sets forth, for the periods indicated, (i) the percentages which the items in the Company's Consolidated Statements of Income bear to total revenues, and (ii) selected operating data:

| | Three Months Ended March 31, | |
|---|---|---|
| | 1992 | 1991 |
| REVENUES | 100.0% | 100.0% |
| COSTS AND EXPENSES: | | |
| Cost of revenues | 37.6 | 37.7 |
| Restaurant operating expense | 41.0 | 41.3 |
| General & administrative | 6.6 | 6.4 |
| Income from operations of unconsolidated affiliates | (4.0) | (1.6) |
| Total costs and expenses | 81.2 | 83.8 |
| INCOME FROM OPERATIONS | 18.8 | 16.2 |
| INTEREST INCOME (EXPENSE), NET | 1.3 | (0.3) |
| INCOME BEFORE ELIMINATION OF MINORITY PARTNERS' INTEREST AND INCOME TAXES | 20.1 | 15.9 |
| ELIMINATION OF MINORITY PARTNERS' INTEREST | 2.5 | 2.0 |
| INCOME BEFORE INCOME TAXES | 17.6 | 13.9 |
| PROVISION FOR INCOME TAXES | 6.7 | 5.3 |
| NET INCOME | 10.9% | 8.6% |
| Operating Data: | | |
| System-wide sales (thousands of dollars) | | |
| Company-owned restaurants | $21,289.3 | $10,440.4 |
| Development joint venture restaurants | 10,609.0 | 3,610.6 |
| Franchised restaurants | 4,912.3 | 2,874.0 |
| Total | $36,810.6 | $16,925.0 |
| Number of restaurants (at end of period): | | |
| Company-owned restaurants | 29 | 19 |
| Development joint venture restaurants | 17 | 8 |
| Franchised restaurants | 8 | 4 |
| Total | 54 | 31 |

**Three months ended March 31, 1991 and 1992**

*Revenues.* Total revenues increased by 104% to $21,461,300 during the first quarter of 1992 as compared with $10,519,700 in the same period in 1991. The increase was attributable to the opening of new restaurants after March 31, 1991, and to a 7.7% increase in same-store sales. The increase in same-store sales was primarily attributable to increased customer counts.

*Costs and expenses.* Costs of restaurant sales, consisting of food and beverage costs, decreased slightly in the first quarter of 1992, to 37.6% of restaurant sales, as compared with 37.7% in the same period in 1991. This decrease was primarily the result of more favorable commodity prices in the first quarter of 1992.

Restaurant operating expenses include all other unit-level operating costs, the major components of which are direct and indirect labor costs, operating supplies, rent, repairs and maintenance, advertising expenses, utilities, depreciation and amortization and other occupancy costs. A substantial portion of these expenses are fixed or indirectly variable. These costs decreased by 0.3% of restaurant sales, to 41.0%, in the first quarter of 1992, as compared with 41.3% in the same period in 1991. This decrease was attributable to higher sales per restaurant.

General and administrative costs increased to 6.6% of revenues during the first quarter of 1992 as compared with 6.4% of revenues in the same period in 1991. This increase reflected higher advertising administrative costs and the cost of additional staffing undertaken to manage and support additional restaurants, including Development Joint Venture restaurants and restaurants operated by unaffiliated franchisees.

Income from operations of unconsolidated affiliates (Development Joint Venture restaurants) increased to $884,700 in the first quarter of 1992 as compared with $173,000 in the same period in 1991. This increase is attributable to additional restaurants in operation and improved sales and margins in restaurants opened prior to March 31, 1991.

*Income from operations.* As a result of the increase in revenues, the changes in the relationship between revenues and expenses discussed above and the opening of new restaurants, income from operations increased by $2,331,100, to $4,043,100, in the first quarter of 1992 as compared with $1,712,000 in the same period in 1991.

*Interest income (expense), net.* Net interest income was $276,600 during the first quarter of 1992 as compared with net interest expense of $33,000 in the same period in 1991. This change was attributable to decreased borrowings and an increase in interest income resulting from higher cash balances as proceeds from the sales of stock were invested.

*Elimination of minority interests.* The costs included in this line item represent the portion of income from operations included in consolidated operating results attributable to the ownership interests of restaurant managers and joint venture partners in Limited

Partnerships and Controlled Joint Ventures. These costs increased in first quarter of 1992 by 0.5% of restaurant sales, to 2.5%, as compared with 2.0% in the same period in 1991. The change in this ratio reflects changes in overall restaurant operating margins combined with changes in specific restaurant or controlled joint venture performance.

*Provision for income taxes.* The provision for income taxes in both quarters reflected expected income taxes due at federal statutory rates and state income tax rates, net of the federal benefits. The effective income tax rates were 38.0% during the first quarter of both 1992 and 1991.

*Net income and pro forma earnings per share.* Net income for the first quarter of 1992 was $2,342,800 as compared with $909,100 in the same period in 1991, an increase of 158%. Earnings per share increased to $0.20 during the first quarter of 1992 as compared with $0.10 for the same period ended in 1991. The increase in earnings per share for the 1992 period as compared with the 1991 period was not proportionate to the increase in net income between the two periods as a result of additional shares outstanding from the sale of stock in June 1991 and January 1992.

## Liquidity and Capital Resources

The following table presents a summary of the Company's cash flows and capital expenditures for the periods indicated.

| | Year Ended December 31, 1991 | Three Months Ended March 31, 1991 | Three Months Ended March 31, 1992 |
|---|---|---|---|
| | | (in thousands) | |
| Net cash provided by operating activities | $ 8,647.2 | $1,391.4 | $ 3,744.1 |
| Net cash used in investing activities | (8,105.7) | (2,476.9) | (4,103.3) |
| Net cash provided by financing activities | 12,708.3 | 485.8 | 23,275.8 |
| Net increase (decrease) in cash | $13,249.8 | $ (599.7) | $22,916.6 |

The Company requires capital principally for the development of new Company-owned and Development Joint Venture restaurants. The Company generally leases its restaurants under operating leases for periods ranging from five to twenty years. In the future, the Company intends to own an increasing proportion of free-standing restaurants where it is cost effective.

Historically, the Company has borrowed funds to finance the purchase of equipment for new restaurants. The Company's borrowings were under five-year term loans from banks at fixed and variable rates ranging from 0.5% to 1.5% above the banks' prime rates. As of March 31, 1992, the Company has repaid all of its borrowings.

The Company expects that its capital requirements through the end of 1993 will be met by cash resources on hand at March 31 1992, and

## PRO FORMA CONSOLIDATED STATEMENT OF INCOME (UNAUDITED)

The following unaudited pro forma consolidated statement of income for the three months ended March 31, 1991 has been prepared to properly reflect the provision for income tax and net income to the Company assuming the partnership exchange agreements and the merger of American Restaurants into the Company described in "Notes to the Consolidated Financial Statements" had been consummated at the beginning of the period presented.

The pro forma adjustments increase the proportionate share of income tax to the Company assuming the income attributed to the exchanging partners and American Restaurants had been income to the Company. Since the Company is not required to pay the pro forma income taxes, no adjustments to the balance sheets have been made.

The pro forma consolidated statements of income should be read in conjunction with the Consolidated Financial Statements and Notes thereto included elsewhere in this report.

# OUTBACK STEAKHOUSE, INC.
## PRO FORMA CONSOLIDATED STATEMENT OF INCOME
## (UNAUDITED)

| | Restated Three Months Ended March 31, 1991 | Pro Forma Adjustments | Pro Forma Three Months Ended March 31, 1991 |
|---|---|---|---|
| REVENUES................. | $10,519,700 | | $10,519,700 |
| COSTS AND EXPENSES | | | |
| Cost of revenues....... | 3,966,100 | | 3,966,100 |
| Restaurant operating expenses............. | 4,345,800 | | 4,345,800 |
| General & administrative expenses............. | 668,800 | | 668,800 |
| (Income) loss from operations of unconsolidated affiliates.......... | (173,000) | | (173,000) |
| | 8,807,700 | | 8,807,700 |
| INCOME FROM OPERATIONS | 1,712,000 | | 1,712,000 |
| NON OPERATING INCOME (EXPENSE) | | | |
| Interest income........ | 15,200 | | 15,200 |
| Interest expense....... | (48,200) | | (48,200) |
| | (33,000) | | (33,000) |
| INCOME BEFORE ELIMINATION OF MINORITY PARTNERS' INTEREST AND INCOME TAXES....... | 1,679,000 | | 1,679,000 |
| ELIMINATION OF MINORITY PARTNERS' INTEREST..... | 212,700 | | 212,700 |
| INCOME BEFORE PROVISION FOR INCOME TAXES........... | 1,466,300 | | 1,466,300 |
| PROVISION FOR INCOME TAXES | 415,900 | 141,300 (1) | 557,200 |
| NET INCOME............... | $ 1,050,400 | $ (141,300) | $ 909,100 |
| EARNINGS PER COMMON SHARE | $ 0.11 | | $ 0.10 |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING | 9,091,000 | | 9,091,000 |

(1) To increase the proportionate share of income tax attributed to the Company pursuant to the Exchange of partnership interest and the merger with American Restaurants described in "Notes to the Financial Statements".

## OUTBACK STEAKHOUSE, INC.

## PART II: OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits - None

(b) Reports on Form 8-K

There were no reports filed on Form 8-K during the quarter ended March 31, 1992.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf of the undersigned hereunto duly authorized.

**OUTBACK STEAKHOUSE, INC.**
(Registrant)

Date: 5/14/92

By:
Robert S. Merritt
Senior Vice President, Finance (Principal Financial and Accounting Officer)

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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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## FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 1992

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________ to ____________

Commission File Number: 0-19442

**OXFORD HEALTH PLANS, INC.**
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

06-1118515
(IRS Employer Identification No.)

320 Post Road - Darien, Connecticut 06820
(Address of principal executive offices) (Zip Code)

(203) 656-1442
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No____

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. The number of shares of common stock, par value $.01 per share, outstanding on May 12, 1992 was 7,434,443.

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# OXFORD HEALTH PLANS, INC.
## INDEX TO FORM 10-Q

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Signature

# OXFORD HEALTH PLANS, INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

| | March 31 1992 (Unaudited) | December 31 1991 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $11,801,529 | $ 7,271,940 |
| Short-term investments (at cost, which approximates market) | 39,744,874 | 38,865,312 |
| Premiums receivable (net of allowance for doubtful accounts of $136,237 in 1992 and $110,212 in 1991) | 4,352,160 | 3,816,988 |
| Other receivables | 2,440,975 | 1,663,394 |
| Prepaid expenses and other current assets | 136,783 | 178,489 |
| Deferred income taxes | 3,106,902 | 1,582,000 |
| Total current assets | 61,583,223 | 53,378,123 |
| Property and equipment, net | 2,130,642 | 2,137,051 |
| Long-term investment (at cost, which approximates market) | 10,201,025 | 10,000,000 |
| Deferred income taxes | 1,153,498 | -- |
| Other non-current assets | 903,884 | 123,860 |
| Restricted cash | 715,000 | 714,225 |
| Total assets | $76,687,272 | $ 66,353,239 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Medical costs payable | $22,437,000 | $18,482,000 |
| Trade accounts payable and accrued expenses | 4,825,977 | 2,942,227 |
| Unearned premiums | 616,040 | 824,720 |
| Deferred rent | 360,000 | 360,000 |
| Other current liabilities | 120,370 | 91,270 |
| Total current liabilities | 28,359,387 | 22,700,217 |
| Deferred rent | 540,000 | 630,000 |
| Total liabilities | 28,899,387 | 23,330,217 |
| Stockholders' equity: | | |
| Common stock, $.01 par value, authorized 13,000,000 shares; issued and outstanding 6,850,008 in 1992 and 6,840,942 in 1991 | 68,500 | 68,410 |
| Additional paid-in capital | 50,269,902 | 50,256,393 |
| Accumulated deficit | (2,550,517) | (7,301,761) |
| Total stockholders' equity | 47,787,885 | 43,023,042 |
| Total liabilities and stockholders' equity | $76,687,272 | $ 66,353,259 |

See accompanying condensed notes to consolidated financial statements

# OXFORD HEALTH PLANS, INC. AND SUBSIDIARIES

## Consolidated Statements of Earnings
## Three Months Ended March 31, 1992 and 1991

(Unaudited)

| | 1992 | 1991 |
|---|---|---|
| Revenues: | | |
| Premiums earned | $30,750,918 | 19,855,063 |
| Third-party administration, net | 1,014,300 | 582,912 |
| Interest, net | 1,000,559 | 285,804 |
| Other | 13,609 | 33,436 |
| | 32,779,386 | 20,757,215 |
| Expenses: | | |
| Health care services | 23,483,118 | 15,649,584 |
| Marketing, general and administrative | 6,770,024 | 3,946,143 |
| | 30,253,142 | 19,595,727 |
| Earnings before income taxes and change in accounting principle (1992) or extraordinary item (1991) | 2,526,244 | 1,161,488 |
| Provision for income taxes | 1,075,000 | 502,000 |
| Earnings before change in accounting principle or extraordinary item | 1,451,244 | 659,488 |
| Change in accounting principle - accounting for income taxes | 3,300,000 | -- |
| Extraordinary item - utilization of net operating loss carryforwards | -- | 406,000 |
| Net Earnings | $4,751,244 | $ 1,065,488 |
| Net earnings per share: | | |
| Earnings before change in accounting principle or extraordinary item | $0.20 | $0.14 |
| Change in accounting principle | 0.46 | -- |
| Extraordinary item | -- | 0.09 |
| Net Earnings | $0.66 | $0.23 |
| Weighted average shares of common stock and common stock equivalents outstanding | 7,173,594 | 4,722,310 |

See accompanying condensed notes to consolidated financial statements

# OXFORD HEALTH PLANS, INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows
Three Months Ended March 31, 1992 and 1991
Increase (Decrease) in Cash and Cash Equivalents
(Unaudited)

| | 1992 | 1991 |
|---|---|---|
| Cash flows from operating activities: | | |
| Earnings before change in accounting principle or extraordinary item | $1,451,244 | $ 659,488 |
| Change in accounting principle | 3,300,000 | -- |
| Extraordinary item | -- | 406,000 |
| Net earnings | 4,751,244 | 1,065,488 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 193,356 | 155,451 |
| Provision for doubtful accounts and billing adjustments | 26,025 | -- |
| Amortization of deferred rent | (90,000) | (90,000) |
| Deferred income taxes | (2,678,400) | (139,000) |
| Loss on disposal of fixed assets | -- | 65,487 |
| Changes in assets and liabilities: | | |
| Premiums receivable | (561,197) | (1,253,865) |
| Other receivables | (777,581) | 203,479 |
| Income taxes | -- | 332,799 |
| Prepaid expenses and other current assets | 41,706 | (42,300) |
| Medical costs payable | 3,955,000 | 4,208,392 |
| Accounts payable and accrued expenses | 1,823,750 | 1,179,589 |
| Unearned premiums | (208,680) | (218,270) |
| Other, net | (750,924) | (14,645) |
| Net cash provided by operating activities | 5,784,299 | 5,452,605 |
| Cash flows from investing activities: | | |
| Capital expenditures | (186,947) | (77,275) |
| Increase in restricted cash | (775) | (1,327) |
| Increase in long-term investment | (201,025) | -- |
| Purchase of short-term investments, net | (879,562) | -- |
| Other, net | -- | 18,750 |
| Net cash used in investing activities | (1,268,309) | (59,852) |
| Cash flows from financing activities - | | |
| Exercise of stock options | 13,599 | -- |
| Net increase in cash and cash equivalents | 4,529,589 | 5,392,753 |
| Cash and cash equivalents at beginning of year | 7,271,940 | 14,956,926 |
| Cash and cash equivalents at end of period | $11,801,529 | $20,349,679 |
| Cash paid for interest and income taxes: | | |
| Interest | $ -- | $ 1,337 |
| Income taxes | $ 338,745 | $ 27,473 |

See accompanying condensed notes to consolidated financial statements

# Oxford Health Plans, Inc. and Subsidiaries
# Notes to Condensed Consolidated Financial Statements

## (Unaudited)

## NOTE 1 - Basis of Presentation

The interim condensed consolidated financial statements included herein have been prepared by Oxford Health Plans, Inc. and Subsidiaries (the "Company") without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures, normally included in the financial statements prepared in accordance with generally accepted accounting principles, have been condensed or omitted pursuant to SEC rules and regulations; nevertheless, management of the Company believes that the disclosures herein are adequate to make the information presented not misleading. The condensed consolidated financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto as of and for each of the years in the three year period ended December 31, 1991, included in the Company's Form 10-K filed with the SEC in March, 1992.

In the opinion of management, all adjustments consisting only of normal recurring adjustments necessary to present fairly the consolidated financial position of the Company with respect to the interim condensed consolidated financial statements have been made. Certain reclassifications have been made to 1991 amounts to conform to 1992 presentation. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year.

## NOTE 2 - Secondary Public Offering

The Company filed a registration statement with the SEC in March, 1992 for a public offering of common stock. This public offering was completed in April, 1992. In this public offering the Company sold 553,273 shares of common stock and the Company realized net proceeds of approximately $9.6 million. Additionally, certain stockholders sold 1,476,654 common shares in this public offering.

The following table sets forth the capitalization of the Company as of March 31, 1992 and as adjusted to give effect to the sale of 553,273 shares of common stock offered by the Company and the application of the estimated proceeds therefrom.

| | As of March 31, 1992 | |
|---|---|---|
| | Actual | As Adjusted |
| Stockholders' Equity: | | |
| Preferred stock, $.01 par value per share, authorized 2,000,000 shares, none issued | $ -- | $ -- |
| Common Stock, $.01 par value per share, authorized 13,000,000 shares, 6,850,008 issued and outstanding, actual and 7,403,281 issued and outstanding, as adjusted | 68,500 | 74,032 |
| Additional paid-in capital | 50,269,902 | 60,128,784 |
| Accumulated deficit | (2,550,517) | (2,550,517) |
| Total stockholders' equity | $47,787,885 | $57,652,299 |

## NOTE 3 - Income Taxes

Effective January 1, 1992, the Company adopted FASB Statement No. 109, Accounting for Income Taxes (Statement No. 109), which requires an asset and liability approach to financial accounting and reporting for income taxes. Deferred income tax assets and liabilities are computed for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to amounts which are more likely than not to be realized. The provision for income taxes is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

The cumulative effect of the accounting change at January 1, 1992 was an increase in deferred tax assets and a corresponding increase in net income of $3,300,000. The Company has not recorded a valuation allowance on its deferred tax assets, based on the availability of carrybacks and anticipated future income consistent with earnings levels and trends for the prior three years. The adoption of Statement 109 did not have an effect upon earnings before change in accounting principle for the first quarter of 1992.

Prior to 1992, the Company computed income taxes on the basis of financial statement income. In addition, the Company recognized an extraordinary credit in the first quarter of 1991 relating to utilization of net operating loss carryforwards in the amount of $406,000.

The Company's provision for income taxes for the three months ended March 31, 1992 and 1991 is as follows:

| | 1992 | 1991 |
|---|---|---|
| Federal: | | |
| Current | $ 230,200 | $227,000 |
| Deferred | 465,800 | 139,000 |
| | 696,000 | 366,000 |
| State and local: | | |
| Current | 223,000 | 136,000 |
| Deferred | 156,000 | -- |
| | 379,000 | 136,000 |
| Total provision | $1,075,000 | $502,000 |

Temporary deductible differences and operating loss carryforwards which give rise to the Company's deferred tax asset at March 31, 1992 are as follows:

| | |
|---|---|
| Medical claims reserve | $2,110,000 |
| Physicians withhold | 542,000 |
| Unearned premiums | 252,000 |
| NOL carryforwards | 1,107,000 |
| Other | 249,400 |
| | $4,260,400 |

During 1991 and 1992, the most significant temporary deductible difference impacting the deferred tax provision related to the Company's medical claims reserve. At March 31, 1992, remaining net operating loss carryforwards for Federal income tax purposes totaled approximately $2,300,000, expiring between the years 2000-2004, and for state and local purposes aggregated approximately $5,000,000 expiring through 2004. The Company's utilization of its federal net operating loss carryforwards is limited to approximately $1.7 million annually for 1992 and beyond due to the limitation imposed by Section 382 of the Internal Revenue Code of 1986, as amended.

The Company's income tax provision differed from the amount computed using the federal statutory rate of 34% as follows:

| | 1992 | 1991 |
|---|---|---|
| Expected tax at federal income tax rate | $ 858,923 | $394,906 |
| State and local income taxes | 249,914 | 89,760 |
| Tax-exempt income | (46,750) | -- |
| Other | 12,913 | 17,334 |
| | $ 1,075,000 | $502,000 |

## ITEM 2.

## Oxford Health Plans, Inc. and Subsidiaries
## Management's Discussion and Analysis of
## Financial Condition and Results of Operations

*The following table shows membership by product.*

Membership at March 31

| | 1992 | 1991 | Increase | Percentage Increase |
|---|---|---|---|---|
| Freedom Plan | 41,000 | 24,730 | 16,270 | 65.8% |
| HMOs | 27,448 | 24,380 | 3,068 | 12.6% |
| Self Funded | 14,700 | 10,340 | 4,360 | 42.2% |
| Total | 83,148 | 59,450 | 23,698 | 39.9% |

*The following table provides certain statement of earnings data expressed as a percentage of total revenue for the three month periods ended March 31, 1992 and 1991:*

| | March 31, | |
|---|---|---|
| | 1992 | 1991 |
| **Revenues:** | | |
| Premiums earned | 93.8% | 95.6% |
| Third-party administration, net | 3.1 | 2.8 |
| Interest, net and other | 3.1 | 1.6 |
| Total | 100.0 | 100.0 |
| **Expenses:** | | |
| Health care services | 71.6 | 75.4 |
| Marketing, general and administrative | 20.7 | 19.0 |
| Total | 92.3 | 94.4 |
| Earnings before income taxes, change in accounting principle or extraordinary item | 7.7 | 5.6 |
| Provision for income taxes | 3.3 | 2.4 |
| Earnings before change in accounting principle or extraordinary item | 4.4 | 3.2 |
| Change in accounting principle | 10.1 | - - |
| Extraordinary item | - - | 1.9 |
| Net earnings | 14.5% | 5.1% |

## Results of Operations

*The three months ended March 31, 1992 compared with the three months ended March 31, 1991.*

Revenues for the first quarter ended March 31, 1992 were \$32.8 million, up 58 percent from \$20.8 million for the same period in the prior year. Net income for the three months ended March 31, 1992 totaled \$4.8 million, or \$.66 per share, including \$3.3 million, or \$.46 per share, attributable to the Company's early implementation of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." (See Note 3 of notes to condensed consolidated financial statements.)

Excluding the effects of this accounting change, the Company's income from operations reached \$1,451,244, a 120 percent increase over the same period in the prior year. Operating earnings per share reached \$.20 compared with \$.14 in the first quarter of 1991, up 43 percent. The share base for the first quarter of 1992 is 52 percent higher than for the comparable year earlier quarter, a result of the August 1991 initial public offering of common stock.

Total fully insured premium revenue for the three months ended March 31, 1992 increased 54.9% to \$30.8 million from the same period in the prior year. This increase is attributable to two factors: (i) a 36.2% increase in member months in Oxford's fully insured managed health care programs to 199,214 member months, with a 45,089 member months or 62.1% increase in the higher priced Freedom Plan; and (ii) an overall weighted average increase in the Company's premium levels of 13.7% for both existing and new clients.

The Company believes that increases in fully insured enrollment will continue in 1992. This is due primarily to increased penetration expected for managed care in the New York metropolitan area and the Company's significantly larger sales force. The increase in premium rates expected in 1992 may be somewhat tempered by lower priced benefit plans selected by employer groups desiring to reduce the cost of health insurance.

Total self-funded premium revenues for the three months ended March 31, 1992 increased 74.0% to \$1.0 million from the same period in the prior year. This increase is attributable to two factors: (i) a 45.8% increase in self-funded member months to 43,100 member months; (ii) and a 19.4% overall weighted average premium increase. The Company expects continued growth into 1992 as more employer groups seek to control medical costs through the combination of self funding and managed care.

Interest income for the three months ended March 31, 1992 increased 250% to \$1.0 million from the same period in the prior year. This increase is due primarily to the increased cash and short-term investments from the August 1991 initial public offering, which generated a net cash infusion of \$32.0 million, and cash provided by operations.

Health care services expense stated as a percentage of total premium revenue, net of commissions to brokers and agents (the "medical-loss ratio") was approximately 78.4% for the quarter ended March 31, 1992 as compared to 80.9% for the quarter ended March 31, 1991. The medical loss ratio declined because revenue per member per month increased at a greater rate than medical expenses per member per month. Per member per month revenue increased 13.7% to \$154.36 in 1992 from \$135.73 in 1991 and per member per month medical expenses increased 10.2% to \$117.88 in 1992 from \$106.98 in 1991.

The Company believes its rate of increase in health care services expense has declined due to significantly improved medical cost containment capabilities, such as claim auditing systems, physician tracking systems and utilization review protocols, and improved risk management. The above savings were partially offset by higher prescription drug costs.

The rate of increase in health care costs has outpaced the consumer price index for the last several years and is expected to continue in the short term. The Company believes that its cost control systems, risk sharing with physicians, and better hospital contracting partially mitigate the effects of inflation.

Marketing, general and administrative expenses increased 71.6% to $6.8 million for the three months ended March 31, 1992 as compared to the same period in the prior year. The major increases were in payroll and benefits, broker commissions and marketing expenses. Payroll and benefits increased $1.4 million, primarily due to increased staffing of new sales and marketing employees. Broker commissions increased 32.3% or $229 thousand due to the associated growth in the Freedom Plan. Marketing expenses increased $213 thousand in the first quarter of 1992 as compared to the same period in the prior year due to increased marketing efforts.

## Liquidity and Capital Resources

The Company believes that its current financial resources at March 31, 1992 are sufficient to meet its liquidity needs.

The Company's cash position as of March 31, 1992 was $11.8 million, an increase of $4.5 million from December 31, 1991. Additionally, the Company's short term investments increased $880 thousand from December 31, 1991. The increase in cash was primarily attributable to cash provided by operating activities of $5.8 million.

The Company's working capital as of March 31, 1992 amounted to $33.2 million, an increase of $2.5 million from December 31, 1991.

The Company believes that the cash flow generated by its operations, its current cash balances, including proceeds from the recently completed public offering, (see Note 2 of notes to condensed consolidated financial statements) and its financing capabilities will be sufficient to fund its continuing operations, capital expenditures and business expansion throughout fiscal years 1992 and 1993.

The Company currently has no definitive commitments for use of its current and expected increased levels of available cash resources; however, management continually evaluates opportunities to expand the Company's managed care services and health plan operations. The Company's expansion options may include acquisitions and internal development of new products and programs. The Company's available cash resources will remain in interest-bearing investments until they are utilized for such purposes.

## Part II - Other Information

Item 1. Legal Proceedings

None

Item 2. Changes in Securities

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit 11 - Computation of Net Income Per Share of Common Stock

(b) Reports on Form 8-K

None

# SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Oxford Health Plans, Inc.
(Registrant)

5-13-92
Date

Stephen F. Wiggins, Chairman, President
and Chief Executive Officer

5-13-92
Date

Andrew B. Cassidy
Chief Financial Officer

# OXFORD HEALTH PLANS, INC. AND SUBSIDIARIES

## Index to Exhibits

**EXHIBIT NO.**

11 Computation of Net Income Per Share of Common Stock

# OXFORD HEALTH PLANS, INC. AND SUBSIDIARIES

## Computation of Net Income
## Per Share of Common Stock - Primary (a)
## (Unaudited)

Exhibit 11

| | Three months ended March 31 | |
|---|---|---|
| | 1992 | 1991 |
| Earnings before change in accounting principle or extraordinary item | $1,451,244 | $ 659,488 |
| Change in accounting principle | 3,300,000 | -- |
| Extraordinary item - utilization of net operating loss carryforwards | -- | 406,000 |
| Net Earnings | $4,751,244 | $1,065,488 |
| Weighted average number of shares outstanding | 6,843,964 | 2,505,205 |
| Dilutive effect of stock options | 329,630 | 259,994 |
| Dilutive effect of convertible preferred stock | -- | 1,927,305 |
| Incremental effect of options issued within one year of IPO | -- | 29,806 |
| Weighted average number of common shares and common share equivalents | 7,173,594 | 4,722,310 |
| Earnings before change in accounting principle or extraordinary item | $0.20 | $0.14 |
| Change in accounting principle | $0.46 | $ - - |
| Extraordinary item - utilization of net operating loss carry forward | $ -- | $0.09 |
| Net Earnings | $0.66 | $0.23 |

(a) All share and per share amounts in the earnings per share computation have been shown giving retroactive effect to the Company's recapitalization of common stock on a one-for-three basis.

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

# FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 1992

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________ to ________

Commission File Number: 33-18099-NY and 33-23169-NY

PHASE-OUT OF AMERICA, INC.
(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| DELAWARE | 22-2418056 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

140 Broadway, Lynbrook, New York 11563
(Address of principal executive offices and zip code)

Registrant's telephone number, including area code: (516) 599-1900

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ____

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of the latest practicable date.

| Class | Outstanding at March 31, 1992 |
|---|---|
| Common Stock, par value $.00003 per share | |

1.30

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PHASE-OUT OF AMERICA, INC. (A Development Stage Company)

FINANCIAL STATEMENTS

March 31, 1992

Financial Statements

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**Robinson & Goldstein**

CERTIFIED PUBLIC ACCOUNTANTS

220 Old Country Road, Mineola, NY 11501
Telephone 516/739-2500
Fax 516/739-2554

PART 1 FINANCIAL INFORMATION
Item 1, financial statements

## ACCOUNTANTS' DISCLAIMER OF OPINION

Shareholders and
Board of Directors
Phase-Out of America, Inc.
Lynbrook, New York

The accompanying balance sheet of Phase-Out of America, Inc. as of March 31, 1992 and the related statements of operations, cash flows and changes in stockholders' equity and schedule of general and administrative expenses for the three month periods ended March 31, 1992 and 1991 were not audited by us and, accordingly, we do not express an opinion or any other form of assurance on them.

We previously examined, in accordance with generally accepted auditing standards, the balance sheet as of December 31, 1991, and the related statements of operations and deficit, and cash flows for the year then ended (not presented herein); and in our report dated March 17, 1992, we expressed an unqualified opinion on those financial statements, but we have not performed any auditing procedures since that date.

Robinson & Goldstein

ROBINSON & GOLDSTEIN

New York, New York
May 19, 1992

## PHASE-OUT OF AMERICA, INC. (A Development Stage Company)

## BALANCE SHEETS

Note 1

| | March 31<br>1992 | <br>1991 |
|---|---|---|
| **ASSETS** | | |
| **CURRENT ASSETS** | | |
| Cash | $ 3,617 | $ 1,186 |
| Accounts receivable -- net of allowance for doubtful accounts of$ - (1992) and $ 1,100 (1991) | 179 | 1,314 |
| Inventory -- stated at the lower of cost or market - first-in first-out | 114,759 | 117,855 |
| Prepaid expenses | 6,920 | 6,610 |
| Loan to affiliate -- including accrued interest $ 4,193 (1992) and$ 3,468 (1991) | 18,724 | 16,898 |
| Rents receivable and other current assets | 4,801 | 3,301 |
| TOTAL CURRENT ASSETS | 149,000 | 147,164 |
| FIXED ASSETS, at cost, net of accumulated depreciation of$ 4,641 (1992) and$ 2,537 (1991) | 3,295 | 3,821 |
| SECURITY DEPOSITS | 934 | 664 |
| BOND DISCOUNT -- Note 7 | 700 | - |
| | $ 153,929 | $ 151,649 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **CURRENT LIABILITIES** | | |
| Accounts payable and accrued expenses | $ 82,385 | $ 63,431 |
| Taxes payable -- Note 6 | 3,920 | 4,981 |
| Amounts due to affiliate -- Note 4 | 2,000 | 500 |
| Loans from Officer/Shareholder - Note 5 | 36,500 | 25,500 |
| TOTAL CURRENT LIABILITIES | 124,805 | 94,412 |
| SUBORDINATED DEBENTURES PAYABLE -- Note 7 | 17,500 | - |
| STOCKHOLDERS' EQUITY -- Note 3 | | |
| Common stock, $0.00003 par value:<br>Authorized shares -- 100,000,000<br>Issued and outstanding shares --<br>38,332,334 at March 31, 1992<br>37,207,334 at December 31, 1991 | 1,150 | 1,116 |
| Capital in excess of par | 936,197 | 913,731 |
| Deficit accumulated in the development stage | 925,723 | (857,610) |
| | 11,624 | 57,237 |
| Commitments and Other Comments -- Note 7 | | |
| Subsequent events -- Note 8 | | |
| | $ 153,929 | $ 151,649 |

## PHASE-OUT OF AMERICA, INC. (A Development Stage Company)

## STATEMENTS OF OPERATIONS

| | Three Months Ended March 31, 1992 | 1991 | July 17,1987 (Inception) to March 31, 1992 |
|---|---|---|---|
| Sales -- net | $ 4,642 | $ 817 | $ 120,622 |
| Cost of sales | 2,891 | 374 | 57,104 |
| Gross Profit | 1,751 | 443 | 63,518 |
| Rental and other income | 1,500 | - | 6,004 |
| Interest and dividend income | 546 | 1,094 | 26,957 |
| | 3,797 | 1,537 | 96,479 |
| Selling, general and administrative (Schedule 1) | 71,910 | 77,934 | 1,022,202 |
| Net loss | $ (68,113) | $ (76,397) | $ (925,723) |
| Loss per share -- Note 1 | NIL | NIL | $ (0.04) |
| Weighted average number of shares outstanding | 37,000,000 | 35,000,000 | 29,000,000 |

# PHASE-OUT OF AMERICA, INC. (A Development Stage Company)

## STATEMENT OF STOCKHOLDERS' EQUITY

From July 17, 1987 (Inception) to March 31, 1992

Note 3

| | Common Stock | | | | |
|---|---|---|---|---|---|
| | Number of Shares(A) (Post Split) | Amount $.0000) Par Value | Capital in Excess of Par Value | Deficit Accumulated During Development Stage | Treasury Stock |
| Sales of Stock for cash ($ .0001 per share) (7/17 - 9/15/87) | 15,990,000 | $533 | | | |
| Sales of Stock for Cash ($.05 per share) (7/17 - 9/15/87) | 3,000,000 | 100 | $49,900 | | |
| Loss for the period of July 31, 1987 (Inception) to December 31, 1987 | | | | $ (3,613) | |
| Balance at December 31, 1987 | 18,990,000 | 633 | 49,900 | (3,613) | |
| Shares held in Treasury -- purchased prior to stock split--reflected post split | (1,800,000) | | | | $60 |
| Adjustment to reflect three - for-one split on 6/21/88 and reduction of par value | | (63) | 63 | | |
| Private placement | 1,800,000 | 60 | 29,940 | | |
| Retirement of Treasury Stock | | (60) | | | ($60) |
| Loss for the year ended December 31, 1988 | | | | (29,430) | |
| Balance at December 31, 1988 | 18,990,000 | 570 | 79,903 | (33,043) | - |
| Proceeds from sales of common stock in initial public offering through March 31, 1989 | 9,095,000 | 273 | 456,477 | | |
| Proceeds from sale of under-writer's unit warrants | | | 5 | | |
| Expenses in connection with initial public offering, including $50,680 deferred at December 31, 1988 | | | (136,459) | | |
| Subtotal | 28,085,000 | 843 | 399,926 | (33,043) | |

(Continued on next page)

## PHASE-OUT OF AMERICA, INC. (A Development Stage Company)

## STATEMENT OF STOCKHOLDERS' EQUITY -- Continued

From July 17, 1987 (Inception) to March 31, 1992

Note 3

| | Common Stock | | | |
|---|---|---|---|---|
| | Number of Shares(A) (Post Split) | Amount $.00003 Par Value | Capital in Excess of Par Value | Deficit Accumulated During Development Stage |
| Balance from previous page | 28,085,000 | $843 | $399,926 | $( 33,043) |
| Closing on maximum sale on initial public offering on April 3, 1989 | 2,905,000 | 87 | 145,163 | |
| Expenses in connection with April 3, 1989 closing on maximum offering | | | (21,033) | |
| Sale of Underwriter's unit Warrants | | | 2 | |
| Exercise of A Warrants (Note 3) | 370,000 | 11 | 36,989 | |
| Loss for the year ended December 31, 1989 | | | | $(238,250) |
| Balance at December 31, 1989 | 31,360,000 | $941 | $561,047 | $(271,293) |
| Exercise of A Warrants | 1,111,000 | 33 | 111,067 | |
| Stock issued for consulting services rendered | 699,334 | 20 | 21,229 | |
| Stock issued to officers as additional compensation (Note 5) | 1,000,000 | 30 | 29,970 | |
| Stock issued for legal services rendered | 135,000 | 4 | 4,046 | |
| Stock issued to employee in lieu of wages | 50,000 | 2 | 1,498 | |
| Loss for the year ended December 31, 1990 | | | | (305,247) |
| | 34,355,334 | 1,030 | 728,857 | (576,540) |

## PHASE-OUT OF AMERICA, INC. (A Development Stage Company)

## STATEMENT OF STOCKHOLDERS' EQUITY -- Continued

From July 17, 1987 (Inception) to March 31, 1992

Note 3

| | Common Stock | | | |
|---|---|---|---|---|
| | Number of Shares(A) (Post Split) | Amount $.00003 Par Value | Capital in Excess of Par Value | Deficit Accumulated During Development Stage |
| Balance from previous page | 34,355,334 | $1,030 | $720,857 | $(576,540) |
| Exercise of A warrants | 1,553,000 | 67 | 155,253 | |
| Stock issued for services rendered: | | | | |
| Employees | 50,000 | 2 | 998 | |
| Lawyers | 400,000 | 12 | 8,738 | |
| Consultants | 849,000 | 25 | 19,085 | |
| Loss for the year ended December 31, 1991 | - | - | - | 281,070 |
| | 37,207,334 | 1,116 | 913,731 | 857,610 |
| Private placement of subordinated debenture units Common stock element | 35,000 | 1 | 699 | - |
| Stock issued for services rendered: | | | | |
| Officers | 1,000,000 | 30 | 19,970 | |
| Consultants | 90,000 | 3 | 1,797 | |
| Loss for the quarter ended March 31, 1992 | - | - | - | 68,113 |
| | 38,332,334 | $ 1,150 | $ 936,197 | $ 925,723 |

# PHASE-OUT OF AMERICA, INC. (A Development Stage Company)
# STATEMENTS OF CASH FLOWS

| | Three Months Ended<br>March 31<br>1992 | <br><br>1991 | July 17, 198<br>(Inception)<br>March 31<br>1992 |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| Net loss | $ (68,113) | $ (76,387) | $ (925,723) |
| Adjustments to reconcile net income to cash used for operating activities: | | | |
| Depreciation | 526 | 526 | 4,641 |
| Decrease (increase) in accounts receivable | 1,135 | 4,055 | (170) |
| (Increase) in inventories | 2,098 | (15,159) | (114,759) |
| (Increase) in prepaid expenses and other current | (1,010) | (3,244) | (11,721) |
| (Increase) in interest due from affiliate | (725) | (289) | (4,373) |
| (Decrease) increase in accounts payable and accrued expenses | 18,954 | 11,167 | 82,194 |
| (Decrease) increase in taxes payable | (1,061) | (1,198) | 4,112 |
| (Decrease) increase in amounts due to affiliated company | 1,500 | (1,239) | 2,000 |
| Expenses paid through the issuance of restricted common stock | 21,800 | 10,300 | 108,250 |
| CASH USED FOR OPERATING ACTIVITIES | (24,698) | (71,308) | (855,550) |
| **INVESTING ACTIVITIES** | | | |
| Acquisition of fixed assets | - | | (7,936) |
| Increase in security deposits | (270) | | (934) |
| CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES | (270) | | (8,870) |
| **FINANCING ACTIVITIES** | | | |
| Proceeds of sales of Common Stock | - | | 660,533 |
| Proceeds from exercise of A Warrants | | 115,300 | 303,400 |
| Proceeds of sale of Underwriter's Unit Warrants | | | 7 |
| Purchase of Treasury Stock | | | (60) |
| Payments of offering expenses | | | (135,492) |
| Advances from officer/stockholder | 11,000 | | 38,000 |
| Repayment of advances from officer/stockholder | | | (1,500) |
| Payments from warrantholders in connection with exercise of A Warrants | | | - |
| Proceeds of bond offering | 17,500 | | 17,500 |
| Decrease in loan to affiliate | | | - |
| Loan to affiliated company | (1,101) | - | (14,351) |
| CASH PROVIDED BY FINANCING ACTIVITIES | 27,399 | 115,300 | 868,037 |
| INCREASE (DECREASE) IN CASH | 2,431 | 43,992 | 3,617 |
| Cash at beginning of period | 1,186 | 23,876 | - |
| Cash at end of period | $ 3,617 | $ 67,868 | $ 3,617 |

## PHASE-OUT OF AMERICA, INC. (A Development Stage Company)

## SCHEDULE OF SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

## SCHEDULE 1:

|  | Three Months Ended March 31, 1992 | Three Months Ended March 31, 1991 | July 17,1987 (Inception) to March 31, 1992 |
|---|---|---|---|
| Officers' compensation Note 5 | $ 35,000 | $ 15,000 | $ 232,981 |
| Advertising and promotion | (1,230) | 12,472 | 155,644 |
| Travel and entertainment | 5,180 | 11,215 | 94,209 |
| Professional fees | 8,300 | 10,830 | 133,888 |
| Rent | 3,657 | 4,811 | 40,253 |
| Telephone | 3,358 | 3,010 | 45,077 |
| Consulting fees | - | - | 39,614 |
| Insurance expense | 4,274 | 3,006 | 42,664 |
| Postage | 394 | 1,519 | 25,127 |
| Auto lease | 4,107 | 4,048 | 41,965 |
| Auto expense | 1,611 | 2,405 | 32,774 |
| Salaries | 2,273 | 3,250 | 46,356 |
| Commissions | - | - | 9,684 |
| Payroll taxes | 373 | 1,665 | 18,237 |
| Utilities | 1,990 | 938 | 12,945 |
| Office supplies and expense | 432 | 581 | 11,731 |
| Printing | - | 247 | 8,712 |
| Miscellaneous | 778 | 1,686 | 11,763 |
| Stock transfer fees | 687 | 604 | 6,308 |
| Repairs and maintenance | - | - | 1,592 |
| Depreciation | 526 | 526 | 4,641 |
| Bad debts | - | 34 | 3,464 |
| State Franchise Taxes | 200 | 86 | 2,573 |
|  | $ 71,910 | $ 77,933 | $ 1,022,202 |

## NOTE 1 -- BACKGROUND AND BASIS OF PRESENTATION

Phase-Out of America, Inc. (the Company) is a development stage company incorporated in Delaware on July 17, 1987, for the purpose of establishing a national network to market and distribute the Phase-Out System (the Product) to retail establishments.

The Company has not generated significant revenues. Operations have been primarily limited to obtaining funds through the issuance of its common stock, in pursuing a public offering of its stock and developing relationships for marketing of its product. There is no assurance that an adequate market can be developed for the product or that profitable operations will be achieved.

The financial statements have been prepared assuming that the Company will continue as a going concern. The Company has suffered recurring losses from operations ($281,270 in 1991, $305,247 in 1990 and $238,250 in 1989) and has limited liquiditity causing an inability to meet its current operating expense obligations. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management's plans regarding these matters are: private placement of Subordinated Debentures (Note 8) to raise $250,000; the Direct Response Marketing agreement described in Note 7 and payment of certain expenses via issuance of restricted Common Stock rather than cash. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

## NOTE 2 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Revenue recognition:

Revenues from the sale of the Phase-Out device are recognized as the products are shipped to customers.

### Income Taxes:

There are no provisions for current or deferred taxes based on income as computed in accordance with current tax laws.

### Loss Per Share:

Net loss per common share is based upon shares outstanding at the end of each fiscal year as retroactively adjusted for the 3-for-1 stock split on June 21, 1988 (see Note 3). Common stock equivalents are not included as their effect is anti-dilutive.

## NOTE 3 -- STOCKHOLDERS' EQUITY

### Public Offering:

In April, 1989, the Company completed the maximum sale of its initial public offering and issued 6,000,000 units (IPO Units, consisting of two shares of of $.00003 par value common stock and one Class A Common Stock Purchase Warrant) at $.10 per unit.

## NOTE 3 -- STOCKHOLDERS' EQUITY -- Continued

### Public Offering (Continued):

The aggregate net proceeds to the Company were $444,155, after deducting underwriting discounts and commissions of $60,000, underwriter's's non-accountable expense allowance of $18,000 and expenses associated with the underwriting of $ 77,845 (including approximately $27,000 in connection with a previous public offering which was aborted).

The underwriting agreement related to the public offering provided the underwriter with Warrants which entitle it to purchase 600,000 units at $.12 per unit, from the period of January 10, 1990 to January 10, 1994. The units underlying the underwriter's Warrants are substantially the same as the IPO Units except that: A Warrants are exercisable at $.12 rather than $.10 and; the underlying warrants are not redeemable.

### Warrants:

The Class A Common Stock Purchase Warrants entitles the holder to purchase one share of common stock and one Class B Common Stock Purchase Warrant (B Warrants) at a price of $.10 per share through November 2,1992 (extended from December 31, 1991). Each B Warrant entitles the holder to purchase an additional share at $.25 per share through December 10, 1992 (extended from July 10, 1992) At March 31, 1992, there were 2,966,000 A Warrants and 3,034,000 B Warrants outstanding (after exercise of 3,034,000 A Warrants described below).

The Class A Warrants are immediately detachable and tradeable separately. The Company has the right to call the Warrants for redemption at $.00001 per Warrant upon 30 days notice. Warrant holders will then have 30 days within which to exercise their Warrants, after which the Warrants will expire.

Through March 31, 1992, 3,034,000 A Warrants were exercised. Of the shares issued, 360,000 were exercised during December 1989 but were not issued until January 1990. As of December 31, 1989, there was due $36,000 from warrantholders in connection with this transaction. This amount was received in January 1990. As of March 31, 1992, there were 2,966,000 outstanding A Warrants.

On June 13, 1988, the Board of Directors authorized reservation of 12,000,000 shares for issuance upon exercise of class A and class B redeemable warrants and 2,400,000 shares for issuance on exercise of Underwriter's Unit Warrants. As of March 31, 1992, 8,966,000 shares remained reserved for Class A and Class B warrants. The Underwriter's Unit Warrants have not been exercised.

## NOTE 3 -- STOCKHOLDERS' EQUITY -- Continued

### Stock Issued to Officers, Consultants and Employees:

In 1990, the Company issued approximately 1,839,000 shares of restricted common stock to officers, employees, special securities counsel and certain consultants in exchange for services rendered.

In 1990 the Company issued, to certain consultants to the Company, options to acquire a total of 350,000 shares of restricted common stock, 250,000 of which is exercisable within two years and 100,000 of which is exercisable within one year, mostly at $0.03 per share.

In 1991, the Company issued 1,299,000 shares to special securities counsel, an employee and certain consultants. In 1992, the Company issued 1,090,000 shares to officers and consultants.

### Issuance of Common Stock Prior to Public Offering:

On July 17, 1987, the Company sold 4,600,000 shares (13,800,000 shares post split) of common stock to two of its officers/directors and 50,000 shares to its special counsel at $.0001 per share (aggregate $465).

In August 1987, the Company sold 600,000 shares (1,800,000 shares post split) of common stock to a private investor for $.0001 per share ($60). In May 1988, these shares were repurchased for $60 and held in treasury until July 1988 at which time the shares were retired. The Company agreed to pay this same shareholder $4,500 from the proceeds of the public offering, for consulting services rendered.

During the period from June 21, 1988 to August 12, 1988, the Company completed a private placement of 1,800,000 shares of its common stock for an aggregate of $30,000.

### Other:

In June 1988, the Company's shareholders approved a decrease in the par value of its shares from $.0001 to $.00003 per share. On the same date, the Board of Directors resolved to affect a three-for-one split of all of its issued and outstanding shares of common stock.

## NOTE 4 -- AMOUNTS DUE TO AND FROM AFFILIATED COMPANY

Amounts due to affiliated company, Products & Patents, Ltd (P&P) consists of unpaid rent of approximately $2,000. The amount due bears no interest.

The Company made a loan to P&P, payable on demand, including interest at 12%. The loan balances were: $18,72 including accrued interest of $4,193 at March 31, 1992 and: $16,898 including accrued interest of $3,468 at December 31, 1991.

## NOTE 5 -- RELATED PARTY TRANSACTIONS

### Office Premises:

The Company used the office facilities of P&P on a rent free basis through September 30, 1987. Effective October 1, 1987, by oral agreement, the Company agreed to pay $500 per month plus utilities and other expenditures for the use of the office facilities.

### Licensing Agreements:

The Company entered into two licensing agreements with P&P concerning distribution rights to the product (Note 7). By agreement dated June 5, 1991, the quotas under the licensing agreement with P&P were waived. This waiver may not have been granted if the Company and P&P were unaffiliated entities, not under common control, dealing on an arms length basis.

### Officers' Employment Contracts:

In June 1988 effective April 1989, the Company entered into five (5) year employment agreements with its President and Vice President. The employment contracts provide for compensation based upon 5% of gross profits, with minimum annual salaries of $35,000 and $25,000 for the President and Vice President respectively. Both contracts provide for bonuses of 2% of gross profits for any year in which pre-tax profits exceed $100,000. The contract with the President provides for a leased automobile, at the expense of the Company, at an approximate annual cost of $6,000 (see Note 7, lease commitments ). Effective July 2, 1990, the contract with the Vice President provides for automobile lease payments.

Compensation and expense reimbursements and allowances for the President and Vice President were as follows:

| | For the Period Ended March 31 | |
|---|---|---|
| | 1992 | 1991 |
| Minimum salary per contract | $ 35,000(a) | $ 15,000 |
| Bonuses paid by issuance of restricted common stock | 20,000 | - |
| | $ 55,000 | $ 15,000 |
| Automobile lease | 4,107 | 4,048 |
| Automobile expenses | 1,611 | 2,405 |
| Entertainment expenses | 5,180 | 11,215 |

(a) 1992 minimum not paid as of March 31, 1992.

## NOTE 5 -- RELATED PARTY TRANSACTIONS -- Continued

### Employment and Stock Ownership of Affiliate:

The President and Vice President are also directors and significant shareholders of the Company and are officers, directors and significant shareholders of P&P. The President of the Company is a Vice President of P&P and and owns approximately 1.4% of the shares of P&P. The Vice President of the Company is the President of P&P, owns approximately 22% of the shares of P&P and, has a part-time employment agreement with P&P.

On June 21, 1988, the officers each contributed 3,000,000 shares (restated for 3-for-1 split) to P&P, making P&P a principal shareholder of the Company.

There may be conflicts of interest if either of the officers devotes time to P&P's interests in the Product and/or other interests of P&P.

### Inventories:

The Company's inventory of devices is stored with P&P's inventory of devices in a warehouse used by the Company and P&P in Bohemia, New York. The rent on the warehouse space is paid by each company under an oral lease, based upon the respective use of space. Additionally, the Company and P&P jointly maintain $1,000,000 of liability insurance. Segregation of owned inventories would be observed more strictly if P&P and the Company were unaffiliated entities, not under common control, dealing on an arms length basis.

### Loans from Officer/Stockholders:

Since 1991 an officer/stockholder loaned $36,500 to the Company. The amount is payable on demand and bears no interest.

### Other:

General Counsel to the Company is a relative of the officers.

## NOTE 6 -- INCOME TAXES

The Company has experienced losses since inception. At December 31, 1991 the Company has available net operating loss carryovers approximating $850,000 which begin to expire in 2002.

The Company has provided for minimum state franchise taxes and taxes based on capital. Such taxes are included in selling, general and administrative expenses in the statement of operations.

## NOTE 7--COMMITMENTS, CONTINGENCIES AND OTHER COMMENTS

License Agreement with Products & Patents, Ltd.:
On September 14, 1987, the Company entered into a license agreement with P&P whereby the Company has an exclusive license to distribute the Product to retailers in the United States and to develop, market and distribute a comprehensive "stop smoking" program to corporations and other large employers. Additionally, the Company was granted the non-exclusive rights to sell the Product outside the United States and to market the Product through direct response type methods, other than direct response television marketing. The agreement is cancellable by P&P under certain specified conditions with 30 days written notice and, cancellable without cause by the the Company upon 90 days written notice. The term of the agreement commenced on March 21, 1989 (the initial closing date of the initial public offering) and ends on March 21, 1999, with an option to renew on written notice by the Company at least 120 days before expiration.

The agreement provides for immediate purchase of the Product of $100,000 within two weeks of the effective date, 100,000 units in the second year and, 200,000 units annually thereafter. The unit cost to the Company shall be $5.00 but may vary depending upon whether the product is manufactured in the United States or outside the United States. The agreement further provides that the Company spend a minimum of $100,000 annually to advertise and promote the product.

On February 7, 1990, the direct response licence agreement with P&P was amended to provide the following:

> Purchase quotas may be met by the Company by manufacturing the product as well as purchasing the product from P&P.
>
> The quota performance period shall be extended by 60 days if the Company needs to manufacture product to meet its quota.
>
> The Company shall have the absolute right to manufacture the product, without the consent of P&P, if P&P is unable to deliver less than 5,000 devices within 30 days or, more than 5,000 devices within 60 days.

The Company has been unable to meet the quotas under this agreement. By agreement dated June 5, 1991, the minimum sales and advertising quotas were unconditionally and permanently waived. The licensing agreement was extended, subject only to continued best efforts by the Company in promoting, selling, marketing and advertising the product.

## NOTE 7 -- COMMITMENTS, CONTINGENCIES AND OTHER COMMENTS -- Continued

### Direct Response Marketing License Agreement:

On May 1, 1989, the Company entered into an agreement with P&P whereby partly in consideration of increasing sales quotas, the Company will have the exclusive right to market and sell the Product in the United States through all direct response methods.

The agreement provides for an initial purchase upon signing, with a purchase quota of $205,000 per year at a specified price per unit. The Company has been unable to meet the quotas imposed by this agreement. By agreement dated June 5, 1991, the minimum sales and advertising quotas were waived and the licensing agreement was extended.

For all orders placed through direct response methods, the Company shall purchase the Product from P&P at a specified per unit price. Furthermore, the Company shall have the right (under specified conditions) to manufacture the Product, subject to a royalty equal to 10% of net sales (as defined) of the Product manufactured by the Company.

### Lease Commitments:

In August 1990, the Company entered into a non-cancellable automobile lease (replacing an April 1989 automobile lease in effect up to that date) requiring minimum monthly rental payments of $658 through August 1994 (approximately $32,000 through the end of the term). The lease provides for a purchase option of $15,000 exercisable at the end of the lease term. There are no renewal options. The automobile under this lease is used by the President (see Note 5).

In February 1991, the Company entered into a non-cancellable automobile lease requiring minimum monthly rental payments of $699 through January 1994 (approximately $26,000 through the end of the term). The lease provides for a purchase option of $26,000 exercisable at the end of the lease term. There are no renewal options. The automobile under this lease is used by the Vice President (see Note 5).

Each of the above automobile leases is personally guaranteed by the respective officer who has use of the vehicle.

### Johns Hopkins School of Medicine Study of the Effectiveness of the Phase-Out Device:

In January 1991, the Department of Psychiatry and Behavioral Sciences of a major medical school issued a report on a study of the effects of the Phase-Out device on human tobacco smoke exposure. This institution is performing further studies on the effectiveness of the Phase-Out system.

## NOTE 7--COMMITMENTS, CONTINGENCIES AND OTHER COMMENTS -- Continued

### Direct Response Marketing Agreement:

On May 2, 1991, the Company entered into an agreement with a direct response marketing firm (the "D.R.M.") whereby the Company granted the exclusive broadcast and cable television rights and certain rights of first refusal and whereby the D.R.M. will produce and air a thirty minute "infomercial". The infomercial (in which all rights and title, as well as all rights of copyright will be owned by the D.R.M.) is to be used to market and sell the Product via direct response (mail and phone order, etc.). Additionally, the D.R.M. provided funding for the medical school study mentioned above.

In exchange for these services, the Company will ship the product at a significantly reduced unit price, but will receive a royalty on adjusted gross sales (as defined). Until such time as the D.R.M. recoups all production costs and funding for the medical school study, 50% of the royalties payable will be withheld from the Company. An additional specified percentage (initially 10% of royalties due under the agreement) will be retained to be applied against customer refunds.

The term of the agreement is three years from the date of commencement of broadcast on a regular basis, with automatic annual extensions unless terminated upon 30 days notice by either party. The agreement further provides for a testing period of 60 days commencing with the date of the agreement, whereby the D.R.M. may determine (subject to certain limitations) not to proceed. If the D.R.M. decides to proceed, then it will use its best efforts to complete the infomercial in 60 days, and will use the 60 day period commencing with completion of the infomercial to test market the infomercial. The last 60 day period will be used by the D.R.M. to determine whether to commence regular broadcast or terminate the agreement. If the D.R.M. then terminates, the right to recoup costs is lost. Despite the fact that all of the deadlines mentioned in this paragraph have passed as of December 31, 1991, the D.R.M. has taken no action to cancel and is continuing its efforts to produce the infomercial.

The Company will not be responsible for costs which the D.R.M. is unable to recoup due to insufficiency of royalties or decision by the D.R.M. not to air the infomercial.

### Private Placement of Subordinated Debentures:

In February 1992, the Company commenced a private placement offering of Subordinated Debentures (the "Debentures") for a total of $250,000 of proceeds in units of $5,000 each.

Each unit consists of: (a) 10,000 shares of common stock and (b) $5,000 two-year subordinated debenture with interest at 10%. The Debentures are convertible as follows:

| | |
|---|---|
| $0.050 | per share for six months |
| 0.075 | per share for one year |
| 0.100 | per share thereafter |

As of March 31, 1992,the Company placed 3 1/2 units for an aggreagate amount of $17,500. Between March 31, 1992 and the expiration of the offering on April 30, 1992 an additional 11 units were places for an aggregate of $55,000.

## NOTE 8 -- SUBSEQUENT EVENTS

### Asset Exchange:

On April 16, 1992 a letter of intent was signed wherein certain parcels of foreign real property or mineral rights may be exchanged for 5% non-cumulative preferred stock with $5,000,000 face value and convertible into 16,666,667 shares of Common Stock at $0.30 per share and other rights and designations as specified. The Company will be obligated to pay a fee of $100,000 with respect to this transaction.

The president of the company with whom the letter of intent was signed is the Special Securities Counsel for the company.

### Acquisition of interest in Distributorship Recruitment Firm:

The company owns a 20% interest in a distributorship recruitment firm (the "DRF").

On May 18, 1992 a void agreement originally dated January 7, 1992 was revived. The agreement provides the DRF with exclusive rights to recruit and appoint independent distributors for non-exclusive marketing rights to retail markets.

The Company plans to conduct a private offering wherein a significant portion of the proceeds therefrom will be loaned to the DRF to purchase inventory of the device,to advertise and promote the device and for the DRF's working capital.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Results of Operations

#### Quarter Ended March 31, 1992 Compared to Quarter Ended March 31, 1991

Since inception the Company devoted substantially all of its efforts to raising capital and has not generated significant revenues. The Company incurred a net loss of $68,113 for the quarter ended March 31, 1992, which was 11% lower than the net loss of $76,397 for the quarter ended March 31, 1991. The cumulative development stage loss through March 31, 1992 was $925,723. The loss for the three months ended March 31, 1992 was 13% lower than the loss incurred during the three months ended March 31, 1991. This reduction resulted from an increase in revenues and an overall reduction in certain non-essential operating costs. The Company reduced its promotional expense during the quarter ended March 31, 1992, incurring a net expense reduction of $1,230 as compared to an expense of $12,472 during the quarter ended March 31, 1991. Officer's compensation was $35,000 for the quarter ended March 31, 1992, including $20,000 in restricted common stock and $15,000 for the quarter ended March 31, 1991.

The Company shares the cost of liability insurance with Products & Patents, Ltd., for a policy naming both parties as insured. The Company has been unable to obtain coverage for cancerous and malignant growth.

#### Liquidity and Capital Resources

The Company used cash for operations of $24,698 and $71,308 for the quarters ended March 31, 1992, and 1991, respectively. Cash received in 1992, $17,500 from a private bond offering (plus $55,000 received in April 1992) added to the cash remaining from previous warrant exercises, and initial revenues from sales of its product were sufficient to sustain essential administrative expenses.

The Company does not have significant long or short term liquidity needs other that to meet its obligations with P&P and provide sufficient working capital to sustain a small office operation. However, the product's success depends heavily on reaching potential customers through advertising. The need for advertising would require significant liquidity.

If the Company's revenues continue at the same rate as for the three months ended March 31, 1992, expenses in certain areas would have to be significantly reduced. Since the Company's operations require minimal fixed overhead costs, management believes that such reductions could be achieved if necessary and operations could continue at reduced levels.

The Company currently has no established sources of financing or unused lines of credit. It is management's hope that revenues from operations and planned private offerings will provide the necessary liquidity to continue operations.

The Company's working capital has deteriorated due to lack of sustained revenues and continued high costs. Working capital and current ratios were:

| | March 31, 1992 | December 31 1991 | March 31, 1991 |
|---|---|---|---|
| Working capital | $24,195 | $52,752 | $196,687 |
| Current ratios | 1.2:1 | 1.6:1 | 12.9:1 |

### Impact of Tax Reform

The Company's liquidity is not expected to be materially affected by any recent or pending tax acts.

### Impact of Inflation

In general, the Company's operations will be affected by inflationary pressures on overhead expenses. The Company's principal product is made substantially of plastic. As such, increased oil prices may result in increased costs of raw materials required to manufacture the product which may affect the ability of the sole supplier to profitably deliver the product at prices agreed to in the licensing agreement.

The labor used to manufacture the product is unskilled or semi-skilled. However, increases in wages may result from inflationary pressures.

The Company's principal product does not have a significant marketing history and therefore the ability to pass on increased costs to customers is uncertain.

### Distribution and Marketing

Over the past several years, the Company has entered into marketing, sales representation, distribution and distributorship agreements with various entities. A number of these entities failed to perform the services required and accordingly the Company terminated the agreements with these entities. However, the Company does have the Synchronol agreement in effect. The Synchronol agreement is for an exclusive in direct response television and a non-exclusive in some other areas of direct response marketing.

The Synchronol project is a direct marketing project wherein Synchronol will fund, produce and air a one-half hour infomercial. initial airing of the show was to serve as a litmus test to see whether or not the show had value. Synchronol hired a professional marketing consultant to review the show in front of two focus groups. As a result, the show is being revised and is now expected to air in July 1992. Synchronol projects, but cannot assure, sales of 15,000 to 30,000 units per months if the show is successful.

The first part of a major clinical research study on the Phase-Out System involving human subjects, by Johns Hopkins University School of Medicine has been concluded and a report was issued. The project had two stated goals: "1) to assess the effectiveness of the Phase-Out device for reducing smoke exposure and 2) to compare withdrawal symptom levels in smokers who do or do not undergo gradual smoking reduction using the Phase-Out device prior to a short term abstinence period. If post-cessation withdrawal symptoms are milder following the smoking reduction procedure than following abrupt cessation, this would lend support to the clinical practice of encouraging gradual smoking cut down prior to quit attempts and support the use of the Phase-Out device for this purpose." Management believes that the favorable results contained in the report on this study will significantly enhance the credibility of the product claims and result in improved sales and profitability. The second part of the study is under way.

Effect of Competing Products

Recently, the FDA approved nicotine patches for prescription by licensed physicians for treatment of nicotine withdrawal. Initially, this appears to be the quit smoking method that is now most commonly prescribed. However, management expects to counter the initial success of the patch program because there are stirrings of adverse publicity regarding patches.

Firstly, the patch program is costly, with physician fees and patch costs totalling in excess of $300 as compared to Phase-Out suggested retail price of $29.95. Furthermore, initial studies indicate that 25% of the patch users have smoked while using the patch. This poses a severe health threat to certain people due to the duplication of nicotine absorption. Management expects to use these aspects of nicotine patches to the Company's advantage in future marketing programs.

## PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Changes in Securities

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a vote of Security Holders

None

Item 5. Other Information

See the Notes to the financial statements.

Item 6. Exhibits and Reports on Form 8-K

10.a Security Asset Management International, Inc. Letter of Intent

10.b Agreements with Product Syndications, Inc.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

PHASE-OUT OF AMERICA, INC.

FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 1992

# EXHIBITS

# EXHIBIT INDEX

10.a Security Asset Management International, Inc. Letter of Intent

10.b Agreements with Product Syndications, Inc.

10.a

**SECURITY ASSET MANAGEMENT**
**INTERNATIONAL, INC.**
**"SAMI"**

515 MADISON AVENUE • NEW YORK, NEW YORK 10022
Tel: (212) 371-7790 • Fax (212) 371-8827

April 16, 1992

Drew Gutman, President
Phase Out Of America, Inc.
140 Broadway
Lynbrook, NY 11563

LETTER OF INTENT

Dear Drew:

The following sets forth the basic terms by which Phase Out of America, Inc. ("POA"), of which you are President, and Security Asset Management International, Inc. ("SAMI") of which I am President, intend to effect an exchange of assets owned by SAMI for stock of POA (the "Transaction").

1. The Assets. SAMI intends to transfer to POA assets consisting of either (a) an interest in a mine located in Mexico or Brazil, or (b) acreage in Brazil or Mexico (the "Assets"). SAMI will decide which Asset to transfer to POA. Whichever of the Assets is chosen, SAMI will provide POA with proof of title, appraisals, description of the Assets, photographs and/or videotapes, and such other documents you reasonably require to satisfy POA and POA's independent attorneys and accountants as to the legality of the transaction and the value of the Assets being transferred to POA.

2. The Stock. In exchange for the Assets, POA intends to issue to SAMI and/or its designees Preferred Stock of POA (the "Stock"). The Stock will have the following rights and designations: (a) face and par value totalling $5,000,000; (b) a 5% non-cumulative dividend; (c) the right to designate one member to POA's Board of Directors for as long as the Stock is not converted to Common Stock; (d) a preference over the Common Stock in the event of liquidation and for dividends: (e) convertible into 16,666,667 shares of POA Common Stock at a price of $.30 per share; and (f) the registration covenant described in paragraph 7(d) herein. The conversion price and number of shares will subsequently be adjusted to give effect to the proposed reverse split described in paragraph 7(c) herein.

3. Fees and Costs. POA will pay SAMI a total of $100,000 as SAMI's fee for the proposed Transaction, payable as follows: (a) within 14 days after the execution of this Letter of Intent by both parties - $10,000; (b) upon the signing of a definitive

agreement (the "Agreement") - $20,000; (c) at the closing of the Transaction, which should take place within 45 days from the date the Letter of Intent is signed - $70,000. Other than this fee, each party shall pay its own costs for the Transaction. It is expressly agreed and understood that POA's failure to pay any of the installment fees as set forth in this paragraph (3) may be treated as a default, but will entitle SAMI only to retain sums already paid, but no consequential or other damages whatsoever including, but not limited to any further payments specified herein.

4. The Agreement. A detailed Agreement will be prepared by counsel and approved, executed and delivered by the Boards of Directors of SAMI and POA as early as practicable. The Agreement will contain the terms set forth herein and other mutually acceptable and customary provisions including, but not limited to representations and warranties of each party to the other, undertakings of each party, conditions precedent to the Transaction and procedures for registration of the Stock being issued to SAMI. SAMI and POA and their respective representatives agree to cooperate and to use their best efforts to cause the Agreement to be executed and delivered on or before May 15, 1992.

5. Representations and Warranties. The Agreement will contain customary representations and warranties by each party thereto with respect to their respective business, financial and legal conditions. The representations and warranties of the parties herein and in the Agreement will survive the consummation of the Transaction and will continue to be enforceable against the parties by whom they were made.

6. Due Diligence. SAMI and POA agree to make available for inspection all corporate books, records and assets concerning POA's business, financial and legal condition and SAMI's Assets, for the purpose of conducting a due diligence investigation of the Transaction. POA may send representations to Mexico to see the Assets and to ask questions and receive all relevant information concerning the Assets. SAMI and POA further agree to keep confidential and not use for their own benefit, except in accordance with the Agreement, any information or documentation obtained in connection with any such investigation.

7. Conditions to the Obligation of SAMI. Without limiting the conditions to the obligation of SAMI in the

Agreement, the Agreement will contain the following conditions to the obligation of SAMI to consummate the Transaction.

(a) Capitalization of POA. POA represents to SAMI that its authorized capitalization currently of 100,000,000 shares of POA, of which 37,207,334 shares are issued and outstanding. POA further represents that there are no other outstanding POA Stock, warrants of other rights to acquire additional shares of POA Stock, except for 2,966,000 shares of POA stock issuable upon exercise of 2,966,000 outstanding POA Class A warrants. and (ii) 3,034,000 shares of POA Stock issuable upon exercise of 3,034,000 outstanding POA class B warrants. Immediately upon the signing of this Letter of Intent, POA will cause its Certificate of Incorporation to be amended to authorize at least 5,000,000 shares of Preferred Stock, $1.00 par value.

(b) POA Financial Condition. POA has represented to SAMI that it has a net worth as of December 31, 1991 of $57,237.

(c) Reverse Split. Immediately upon completing the Transaction, POA will effect a reverse split of its currently outstanding Common Stock such that the minimum bid price of the Common Stock after the reverse split can reasonably be projected to be at least $4.00.

(d) Registration. Immediately upon consummation of the Transaction, POA will prepare, file and use its best efforts to have declared effective a registration statement on Form S-1 covering the Stock and the Common Stock issuable upon conversion of the Stock. In addition, immediately upon completion of the Transaction, POA will register its Common Stock under Section 12(g) of the Securities Exchange Act of 1934.

(e) NASDAQ Application. Immediately upon completion of the Transaction, POA will prepare and file a Form 8-K disclosing the Transaction and containing financial statements including the Assets, and will file and use its best efforts to have accepted an application to have its Common Stock listed on the NASDAQ System.

(f) No Litigation or Governmental Proceedings. No litigation or governmental proceeds shall be pending or threatened with respect to POA, its assets or the Transaction contemplated hereby.

8. Conditions to the Obligation of POA. Without limiting the conditions to the obligation of POA in the Agreement, the Agreement will contain the following conditions to the obligation of POA to consummate the Transaction:

(a) The Assets. SAMI will transfer to POA at closing good and marketable title to the Assets, free and clear of all claims, liens and encumbrances of any kind or nature, including title transfer taxes.

(b) Value of the Assets. By appraisals and similar methods of valuation, SAMI will satisfy POA that the value of this Assets being transferred to POA in the Transaction as will be shown on POA's balance sheet is at least $5,000,000.

(c) Information. Before and after the closing of the Transaction, SAMI will provide POA and its independent attorneys and accountants whatever information is reasonable requested to prepare, file and have declared effective the Forms S-1 and Form 8-K, and the NASDAQ Application.

(d) No Litigation or Governmental Proceedings. No litigation or governmental proceedings shall be pending or threatened with respect to SAMI, the Assets or the Transaction.

9. Public Disclosure. SAMI and POA agree that there will be no press release or other public disclosure of the proposed Transaction contemplated hereby unless and until this Letter of Intent has been executed and delivered by the parties. At such time, any such press release or other public disclosure, and any Form 8-K report prepared for filing by POA, shall be reviewed by SAMI prior to its publication or filing.

10. Nature of this Letter. Upon acceptance of this offer by POA, it is understood that this letter will constitute a statement of the mutual intentions of the parties with respect to the proposed Transactions, although it does not contain all matters upon which agreement must be reached in order for the proposed transaction, to be consummated and, except as to paragraphs 6 and 9, creates no binding rights in favor of either party. A binding agreement with respect to the proposed Transaction will result only after the acceptance of this offer by POA and the execution by the parties of the Agreement.

11. Finders' Fees and Commissions. SAMI and POA represent to each other that no finders' fees or commissions have been or will be incurred as a result as a result of the consummation of the proposed Transaction.

12. Counterpart Execution. This letter may be executed by the parties in counterparts, all of which shall constitute one and the same original.

13. Amendment. The terms of this letter may be amended, modified or waived only in writing by the parties hereto.

14. Governing Law. This letter shall be governed and construed in accordance with the laws of the State of New York.

If the foregoing correctly set forth the material terms of your understanding of the proposed Transaction, and if such terms are acceptable to you, please execute two originals of this letter and return one executed original to the undersigned. We look forward to completing the Transaction.

Very truly yours,
SECURITY ASSET MANAGEMENT
INTERNATIONAL, INC.

By: ______________________
John B. Lowy, President

**ACCEPTED AND AGREED**
this __th day of April, 1992:

PHASE OUT OF AMERICA, INC.

BY: Drew Gutman President
Drew Gutman, President

[POAI0057.042]

10.b

# AGREEMENT

Agreement made this 7th day of January, 1992, between Product Syndications, Inc. offices located at 192 Gardner Avenue, Jericho, New York 11753 (hereinafter referred to as "PSI") and Phase-Out of America, Inc. with its offices located at 140 Broadway, Lynbrook, New York 11563 (hereinafter referred to as "POA").

WHEREAS, POA represents that it is the owner of the exclusive United States marketing rights of the PhaseOut Device ("the Device"), United States Patent No. 4231378.

WHEREAS, PSI represents that it has substantial expertise and experience in selling distributorships for various products such as the device. It has developed successful techniques for the recruiting of distributorships via newspaper advertisements, business opportunity magazines and business opportunity shows.

NOW, THEREFORE, in consideration of the mutual covenants and promises set forth herein, the parties intending to be legally bound do hereby agree as follows:

1. POA engages PSI to exclusively handle business opportunity shows and to recruit independent distributors through newspaper advertisements, magazines and other business opportunity publications, only, except that this engagement shall not include the recruitment of independent distributors through the exploitation of POA's customer lists or other methods not specifically referred to herein. Approval of other methods will not be unreasonably withheld.

2. PSI shall use its best efforts to appoint distributors through traditional advertising methods, including but not limited to newspaper advertisements, magazine advertisements and business opportunity shows.

3. PSI shall use its best efforts to provide its distributors with proper sales training, proper sales techniques, sales and promotional literature, product information, order forms and any and all pertinent material necessary for the

distributors' success. PSI shall provide each distributor with up to date information on the device and the Company by mail on an ongoing basis (through periodic newsletters and bulletins) so that each distributor has the opportunity to maximize its own sales. Said information shall include among other things, customer testimonials, newspaper, radio and television publicity and any addition clinical research reports.

PSI shall submit to POA copies of all proposed advertisements newsletters, bulletins and other sales materials to POA for POA's written approval. Said approval shall not be unreasonably witheld.

4. PSI shall be solely responsible for any and all expenses and costs involved in the sale of distributorships.

5. Each distributor that PSI appoints can sell the device to all retail markets on a non-exclusive basis, such as drug stores, convenience stores, department stores, etc. including but not limited to door to door sales, health organizations, home party plans, doctor/dentist and other professional offices, hospitals, weight loss centers, office buildings, fund raising groups and fraternal organizations. Distributors must get prior approval to sell "chain store accounts" ... A chain store account is defined as any retailer with an excess of 25 outlets. The only marketing method distributors cannot pursue is the direct response sale to consumers through television advertising. If the distributor seeks to sell the device in other undefined markets, said distributor must obtain approval in writing beforehand from PSI who in turn will obtain approval in writing from POA. Said approval will not be unreasonably withheld. In this regard, it is expressly understood that POA has already granted the exclusive national direct response television and other rights to Synchronal Corporation. In the event PSI sells directly to an approved chain account that requires a relationship directly with POA, PSI will receive no less than a ten percent (10%) commission from POA.

POA reserves the right to review and approve of the form and content of all distributor agreements used by PSI.

6. Term and Continued Requirements: The term of this Agreement is for a period of ten (10) years commencing with the execution hereof subject to the terms and conditions stated herein including PSI's satisfactory performance under the sales quotas stated below.

7. Initial Order: PSI guarantees an initial order of 2,000 devices within sixty days from the date of this Agreement. PSI is currently seeking financing up to $150,000. If their financing is successful in the amount of $100,000, PSI will place an initial order of 3,000 devices. If $150,000 is raised, then the initial order will be 5,000 devices. If no initial order is made by PSI within the sixty (60) days then this agreement is null and void.

8. Quotas: The quota for the first year period ending December 31, 1992 shall be a minimum purchase of 25,000 devices. The quota for the remaining years shall be 50,000 devices per annum.

9. Cost of the Device. The cost of the device to PSI is $8.00 per device, F.O.B. Long Island, New York. Each device shall consist of a handsome package and instruction booklet. In the event POA's costs are increased by the cost of manufacturing than said costs of the device will be passed along to PSI, not to exceed 5% per year.

10. POA agrees to cooperate and support PSI in its efforts to sell distributorships by supplying PSI with any and all sales and promotional material it has at its disposal or any material requested, the charge shall not exceed 5% (percent) over POA's cost.

11. POA grants the right to PSI to reproduce any and all sales material, at PSI's own cost and expense with the understanding that any reproduction shall be in conformity with the product's image and already existing published literature, anything else shall require the written approval of POA and said approval shall not be unreasonably withheld.

12. PSI shall not provide its distributors with any other smoke cessation product for sale to the public without the express written approval of POA. Furthermore, PSI agrees that it shall not allow any of its distributors to sell to the public a competing product. In this regard, PSI shall have each of its distributors sign a restrictive covenant in its agreement with its distributors.

13. Payment: Payment for the device is either by cash in advance or C.O.D. No terms allowed.

14. Agency: The parties hereto are independent contractors. No joint venture, partnership or agency is contemplated by the parties (except as expressly indicated herein). Each party is to bear its own costs and expenses in regard to their respective responsibilities and performance hereunder, and neither shall be bound to the costs or expenses incurred by the other. Any and all representation, warranties, guarantees or other promises to be made in connection with PSI's sale or marketing of the Device must be approved by POA in writing. POA shall not be bound by, and PSI shall bear a full responsibility for, such acts, representation and conduct which are not expressly approved by POA in writing.

15. Termination: This Agreement may be terminated as provided above in the event that PSI fails to meet any of the minimum sales quotas set forth above, if PSI fails to place the initial order, if PSI fails to use its best efforts, if PSI fails to place a minimum of two advertisments for disributors during any one month period or may be terminated by either party in the event that the other party (i)

shall make an assignment for the benefit of creditor or a public admission of Insolvency; (ii) shall be dissolved or shall lose its charter by forfeiture or otherwise; (iii) shall be adjudicated a bankrupt or insolvent or if a trustee, receiver or liquidator shall be appointed for that party or for any of its respective properties or for any substantial part thereof: (iv) any court or governmental authority or agency shall have taken jurisdiction of the property or business of that party, or any substantial part thereof, in any proceeding for reorganization, dissolution, liquidation or winding up of that party's business, and such trustee or receiver shall not be discharged or such jurisdiction relinquished or vacated within thirty (30) days thereafter; or (v) shall file a voluntary petition in bankruptcy under any bankruptcy or insolvency law or any law providing for reorganization, dissolution, liquidation or winding up or shall consent to the appointment of a receiver or trustee of itself or of its property or of any substantial part thereof. In the event that either party at any time commits or allows to be commited a breach of any obligation set forth to be performed or observed by it under this Agreement or in the event of any assignment hereof by PSI without prior written consent of POA or if PSI delegates its duties hereunder or creates any sub-distributorship or agency without POA's prior written consent, then the non-breaching party may by notice in writing given to the other, require such breach or event to be remedied within thirty (30) days of such notice. If it is not so remedied this Agreement shall without further notice be terminated at the election of the non-breaching party.

In the event POA wishes to terminate this Agreement with PSI and PSI is in compliance with the terms of this Agreement, POA may purchase back the distribution rights based upon the following formula:

2.5 x the amount of total purchase volume made by PSI to POA over the last 12 months from the date of buyout.

16. Consideration. It is understood that the PSI principles are being given this exclusive agency in consideration for their individual efforts on behalf of POA.

17. Entire Agreement: This Agreement constitutes the entire Agreement between the parties; it supersedes any prior Agreement or understandings between the parties, whether such prior Agreement or understandings were oral or written, all of which are hereby cancelled. No warranties or representations are made other than as set forth herein. No amendment or changes to this Agreement shall be binding unless made in writing and signed by both parties.

18. Notices: Any notices required hereunder shall be effective and binding if sent by prepaid, registered mail, telegram, cable or delivered in person to the party. All notices hereunder shall be deemed to have been received on the date shown by the certified mail receipt or the date served personally upon either of the parties at their respective addresses as set forth below.

For: PHASEOUT OF AMERICA, INC. its offices at:
140 Broadway
Lynbrook, New York 11563

For: KRAVER & LEVY its offices at:
David Levy
909 Third Avenue
New York, New York 10022

For: PRODUCTS SYNDICATIONS, INC. its offices at:
192 Gardner Avenue
Jericho, New York 11753

19. New York Law to Apply: This Agreement shall be construed under and in accordance in the laws of the state of New York.

20. Legal Construction: In any case any one or more of the provisions contained in this Agreement shall, for any reason, be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision thereof and this Agreement shall be construed as if

such invalid, illegal or unenforceable provision had never been contained herein.

21. Non-Waiver: Failure of either party at any time to require performance of any provisions of this Agreement, shall not affect the right to require full performance at any time thereafter and waiver by either party of a breach of any such provision shall not constitute a waiver of any subsequent breach or nullify any such provision.

**IN WITNESS WHEREOF**, the parties hereto, intending to be legally bound, have set their hand and seals and have hereby executed this Marketing Agreement as of the date first above written.

ATTEST:

PHASEOUT OF AMERICA, INC.

Bernard Gutman
Chairman

ATTEST:

PRODUCT SYNDICATIONS, INC.

Bernard Keil

Bernard Keil
Chairman

# AGREEMENT

**AGREEMENT** made this 18th day of May, 1992, between PRODUCT SYNDICATIONS, INC., with offices located at 192 Gardner Avenue, Jericho, New York 11753 (hereinafter referred to as "PSI") and PHASE-OUT OF AMERICA, INC. with offices located at 140 Broadway, Lynbrook, New York 11563 (hereinafter referred to as "POA").

**WHEREAS**, PSI and POA entered into an agreement dated January 7, 1992 (the "Agreement"), a copy of which is attached hereto as Exhibit "A".

**WHEREAS**, the Agreement became null and void on or about March 7, 1992 in accordance with the terms set forth in paragraph "7" of the Agreement.

**WHEREAS**, PSI and POA each desire to enter into a new agreement identical to the Agreement.

**NOW, THEREFORE** in consideration of the mutual covenants and promises set forth herein, the parties intending to be legally bound do hereby agree as follows:

1. All of the terms of the Agreement (which Agreement is attached hereto as Exhibit "A"), except as set forth below, are, by this reference, incorporated herein.

2. The Term of this agreement as set forth in Paragraph "6" of the Agreement, and the initial order and quota periods set forth in paragraphs "7" and "8" of the Agreement commence as of the date hereof.

IN WITNESS WHEREOF, the parties hereto, intending to be legally bound, have set their hand and seals and have hereby executed this Marketing Agreement as of the date first above written.

ATTEST:

PHASE-OUT OF AMERICA, INC.

Bernard Gutman
Chairman

ATTEST:

PRODUCT SYNDICATIONS, INC.

Bernard Keil
Chairman

# AGREEMENT

This Agreement is made and entered into this day of May, 1992 by and between **PHASEOUT OF AMERICA, Inc.** ("POA") and **PRODUCT SYNDICATIONS, INC.** ("PSI").

## WITNESSETH

**WHEREAS, LIDO EQUITIES CORP.** ("LIDO") has agreed, on a best efforts basis, to assist POA raise up to $600,000.00 in capital in POA's Private offering of Convertible Preferred Stock. The amount of capital raised by LIDO for POA in the offering will be divided between PSI and POA, net of all offering and selling expenses and the requisite 12% reserve for the sinking fund, as follows:

The first $300,000.00 raised by LIDO will be split equally on a 50/50 basis, each to PSI and POA.

All of the next $100,000.00 raised by LIDO will be given to POA only for the specific purposes of effectuating an acquisition between POA and another Company with the assistance of JOHN LOWY, ESQ.

The remaining $200,000.00 raised by LIDO will also be split equally on a 50/50 basis between POA and PSI.

An interest reserve or sinking fund will be set up to provide for the 12% interest due to the investors. These funds will be held by an attorney in a separate interest bearing escrow account.

It is expressly understood that the Preferred Stock Offering is by POA, a publicly held company, and that PSI will not be entitled to any funds from offering proceeds raised without LIDO's assistance. All checks are made payable to John B. Lowy, Attorney, Trust Account and immediately distributed as outlined above. However, it is expressly understood and agreed to that any funds received by PSI from said distribution will be in the form of a loan from POA.

The term of the loan will be for five years. PSI agrees to pay a 12% interest rate per annum on any and all funds received. Interest payments to be made quarterly. The first year's interest payment to be accrued the first year. PSI and POA agree to enter into a formal promissory note and loan agreement, following the exact parameters above, immediately after the first monies are raised by LIDO, but before funds are distributed to PSI.

PSI will use all of the proceeds from this loan solely for marketing and distribution of the PHASEOUT System persuant to its agreement dated January 7, 1992, as revived by agreement dated May 18, 1992. The proceeds will be used in accordance with the following guidelines: Purchase of inventory; 35%, Advertising and Promotion; 45% and Working Capital; 20%.

Agreed and Accepted:

**PHASEOUT OF AMERICA, INC.**

By: ______________________________
Bernard Gutman

Chairman

By: Drew Gutman
Drew Gutman
President

**PRODUCT SYNDICATIONS, INC.**

By: ______________________________
Bernice Keil
President

## SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registration has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PHASE-OUT OF AMERICA, INC.

Dated: May 19, 1992

Drew Gutman, President
and Treasurer

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# Form 10-Q

## SECURITIES & EXCHANGE COMMISSION
Washington, D.C. 20549

## QUARTERLY REPORT PURSUANT TO SECTION 13 TO 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the 9 months ended
March 31, 1992

Commission File No.
33-255516-NY

## TREATS INTERNATIONAL ENTERPRISES, INC.
(formerly S.L. Resources, Inc.)

State of jurisdiction:
DELAWARE

I.R.S. Employer No.:
13-3495199

Address of Principal Executive Officers:
418 Preston Street
Ottawa, Ontario
Canada
K1S 4N2

Telephone No.: (613)563-4073

Former Name and Address:

S.L. RESOURCES INC.
450 7th Avenue
New York, New York
10001

Former Fiscal Year: September 30 (Changed to June 30 by filling S-18, filed in March 1992)

Registrant has filed all reports under Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months and has been subject to such filing requirements for the past 90 days:

YES

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# TREATS INTERNATIONAL ENTERPRISES, INC.
(formerly S.L. RESOURCES, INC.)

## FORM 10-Q

## NINE MONTHS ENDED MARCH 31, 1992

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TREATS INTERNATIONAL ENTERPRISES, INC.
CONSOLIDATED BALANCE SHEETS

| | March 31<br>1992<br>(Unaudited) | June 30<br>1991<br>(Audited) |
|---|---|---|
| ASSETS | | |
| Current assets | | |
| Accounts receivable | $325,070 | $315,857 |
| Prepaid expenses | $92,502 | $65,088 |
| Current portion of Notes receivable | $155,000 | $75,000 |
| Short term Investments | $21,561 | ------- |
| Total current assets | $594,133 | $455,945 |
| Stores held for resale | $306,793 | $26,425 |
| Notes receivables | $518,509 | $363,094 |
| Property and Equipment | $198,988 | $167,722 |
| Franchise rights | $12,366,309 | $12,789,759 |
| Deferred charges | $154,520 | ------- |
| | $14,139,252 | $13,802,945 |
| LIABILITIES & SHAREHOLDERS EQUITY | | |
| Current liabilities | | |
| Bank Indebtedness | $61,183 | $513,334 |
| Accounts payables and accrued liabilities | $2,292,844 | $2,376,261 |
| Provision for closure of corporate stores | $224,211 | $817,000 |
| Current portion of long term debt | $250,000 | $450,000 |
| Total Current liabilities | $2,828,237 | $4,156,595 |
| LEASE SECURITY DEPOSITS | $204,897 | $184,978 |
| ADVERTISING COMMITMENTS | $276,127 | $343,289 |
| TERM DEBT (Note 3a) | $2,692,813 | $1,892,500 |
| DEFERRED INCOME | $300,572 | ------- |
| SUBORDINATED DEBENTURE (Non-interest bearing, Note 3b ) | $4,701,011 | $6,576,895 |
| | $8,175,420 | $8,997,662 |
| NON CONTROLLING INTEREST (Note 4) | $232,001 | $2,289,501 |
| SHAREHOLDERS EQUITY | | |
| Share capital (Note 5) | $7,978,686 | $2,997,255 |
| Foreign exchange adjustment | $9,798 | $22,164 |
| Deficit | ($5,084,890) | ($4,660,232) |
| Total shareholders equity | $2,903,594 | ($1,640,813) |
| | $14,139,252 | $13,802,945 |

TREATS INTERNATIONAL ENTERPRISES, INC.
CONSOLIDATED STATEMENTS OF REVENUE,EXPENSES AND DEFICIT
(UNAUDITED)

| | For the fiscal quarter ended | | For the three fiscal quarters ended | |
|---|---|---|---|---|
| | March 31 1992 | March 31 1991 | March 31 1992 | March 31 1991 |
| **REVENUE** | | | | |
| Royalties | $462,104 | $418,314 | $1,394,053 | $1,390,445 |
| Franchising | $175,250 | $48,750 | $417,564 | $431,250 |
| Other | $453,712 | $623,159 | $1,552,857 | $2,039,694 |
| Total revenue | $1,091,066 | $1,090,223 | $3,364,474 | $3,861,389 |
| COST & EXPENSES | | | | |
| Regional Operations | $80,620 | $127,707 | $242,574 | $300,420 |
| Franchising | $62,662 | $118,204 | $198,986 | $287,769 |
| Head office & Admin. | $366,719 | $551,670 | $1,082,354 | $1,368,576 |
| Corporate store | $263,407 | $511,749 | $1,027,811 | $1,518,224 |
| Total Cost & Expenses | $773,408 | $1,309,330 | $2,551,725 | $3,474,989 |
| EARNINGS BEFORE INTEREST,DEPRECIATION AMORTIZATION AND LOSS ON CORP.STORE | $317,658 | ($219,107) | $812,749 | $386,400 |
| Interest on Long term debt | $241,439 | $338,287 | $813,957 | $807,481 |
| Depreciation and Amortization | $141,150 | $144,198 | $423,450 | $424,593 |
| Loss on sale of Corp. Store | ------- | ($19,098) | ------- | ($3,273) |
| | $382,589 | $501,583 | $1,237,407 | $1,235,347 |
| NET LOSS | ($64,931) | ($720,690) | ($424,658) | ($848,947) |
| Deficit Begining of period | ($5,019,959) | ($128,257) | ($4,660,232) | ------- |
| Deficit End of period of period | ($5,084,890) | ($848,947) | ($5,084,890) | ($848,947) |
| (Loss) per Share | ------- | ($0.02) | ($0.01) | ($0.02) |
| Average number of shares | 37,500,000 | 37,500,000 | 37,500,000 | 37,500,000 |

NOTE: The (Loss) per share is base on the number of shares as adjusted for the reverse acquisition.

TREATS INTERNATIONAL ENTERPRISES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOW
(UNAUDITED)

| | For the fiscal quarter ended | | For the three fiscal quarters ended | |
|---|---|---|---|---|
| | March 31 1992 | March 31 1991 | March 31 1992 | March 31 1991 |
| **Operating activities** | | | | |
| Net Loss | ($64,931) | ($720,690) | ($424,658) | ($848,907) |
| Items not affecting cash | | | | |
| Depreciation | $20,250 | $18,250 | $60,750 | $54,750 |
| Amortization | $120,900 | $125,948 | $362,700 | $369,843 |
| Interest expense - added to Debenture | $170,734 | ------- | $535,149 | ------- |
| | $246,953 | ($576,492) | $593,941 | ($424,314) |
| Changes in non - cash working capital items | ($308,573) | ($398,882) | ($1,226,150) | ($489) |
| | ($61,626) | ($975,374) | ($632,209) | ($424,803) |
| **Financing activities** | | | | |
| Equity issued related to Treats Inc | ------- | ------- | ------- | $2,997,255 |
| Long term debt RBCC/Std.Chartered | ------- | ($157,500) | $330,554 | $7,427,158 |
| Repayment of debt (Oakwest) | ------- | ------- | ------- | ($2,840,672) |
| Minority Interest / Special shares | $1 | ------- | $1 | ------- |
| Equity issued related to restructuring (Note 5h) | $5,009,746 | ------- | $5,009,746 | ------- |
| Tri-Capital Loan | $250,060 | ------- | $250,060 | ------- |
| Lease security deposit | $3,336 | $4,859 | $19,919 | $171,211 |
| Advertising Liabilities | ($35,497) | ------- | ($67,161) | $300,000 |
| Other long term debt | $350,000 | ------- | $350,000 | ------- |
| | $5,577,646 | ($152,641) | $5,893,119 | $8,054,952 |
| **Investing activities** | | | | |
| Acquisition - Treats Inc. | ------- | ------- | ------- | ($7,773,059) |
| Purchase of US area rights | ------- | ------- | ------- | ($816,494) |
| Org.cost incured / Acquire Subsid. | ($144,870) | ------- | ($202,150) | ($1,936,637) |
| Issue of Notes Receivable | ($347,303) | $42,610 | ($97,824) | ($62,688) |
| Purchase of Properties and equipment | ------- | ($42,140) | ------- | ($97,911) |
| Reduction of Subordinate debenture | ($2,451,284) | ------- | ($2,451,284) | ------- |
| Coversion of minority interest | ($2,057,501) | ------- | ($2,057,501) | $2,289,001 |
| | ($5,000,958) | $470 | ($4,808,759) | ($8,397,788) |
| Increase (Decrease) in Cash | $515,062 | ($1,127,545) | $452,151 | ($767,639) |
| Cash - Beginning of period | ($576,245) | $359,906 | ($513,334) | $0 |
| Cash - End of period | ($61,183) | ($767,639) | ($61,183) | ($767,639) |

TREATS INTERNATIONAL ENTERPRISES, INC.
Formerly S.L. Resources, Inc. & Triadon Capital Corporation
Notes to the Consolidated Financial Statements
March 31, 1992
(Unaudited)

## BASIS OF UNAUDITED INTERIM FINANCIAL STATEMENT PRESENTATION

### (1) UNAUDITED INTERIM STATEMENTS

The consolidated financial statements as of March 31, 1992 and 1991 and for the nine months ended March 31, 1992 and 1991 are unaudited; however, in the opinion of management all adjustments (consisting solely of normal recurring adjustments) necessary to a fair presentation of the financial statements for these interim periods have been made. The results of the interim periods are not necessarily indicative of the results to be obtained for a full fiscal year.

Treats International Enterprises, Inc. (the Company) was originally organized as S.L. Resources, Inc. (SLR) under the laws of the State of Delaware on October 28, 1988 and had adopted a fiscal year end of September 30. Prior to January 31, 1992, SLR had not commenced operations and was considered a development stage company. On January 31, 1992, SLR acquired all of the outstanding shares of Triadon Capital Corporation in exchange for 30,000,000 common shares, representing 80% of the issued share capital. SLR then changed its name to Treats International Enterprises, Inc. and adopted the year end of June 30.

This acquisition has been accounted for as a reverse acquisition using the purchase method of accounting. The financial statements prior to January 31, 1992 are those of Triadon Capital Corporation, (TCC), the acquiror and the continuing company.

### (2) CONTINUATION OF BUSINESS

While the consolidated financial statements have been prepared on the basis of accounting principals applicable to a going concern, several conditions cast substantial doubt upon the validity of this assumption.

The company incurred a net loss of $424,658 for the nine months ended March 31, 1992. The capital deficiency which existed prior to the reverse acquisition has been rectified, and working capital has been improved by $1.0 Million leaving a deficit working capital of approximately $2.2 Million. The continuation of the Company is dependent upon obtaining sufficient additional cash investment and the achievement of sustained profitable operations.

2 continued

On March 24, 1992, the company filed a prospectus with the SEC related to 7,000,000 Class A and 7,000,000 Class B common share purchase warrants that, if exercised, will result in the issue of 14,000,000 common shares for cash consideration of U.S. $1,470,000.

Because the exercise of these warrants remains dependent upon future events and circumstances, there can be no assurance that the Company will obtain sufficient additional cash equity, attain sustained profitability and be able to maintain the covenants in its current loan agreement. If the going concern assumption was not appropriate for these consolidated financial statements, then adjustments would be necessary in the carrying values of assets and liabilities, the reported net loss and the balance sheet classification used.

## (3) LONG TERM DEBT

| | | | Audited |
|---|---|---|---|
| | | March 31 1992 | June 30 1991 |
| Standard Chartered Bank of Canada - Demand Loan | (Note 3(a) | 2,342,500 | 2,342,500 |
| Promisory Note 15% - TriCapital | | 250,060 | --- |
| Other - Long Term Debt | | 350,313 | --- |
| | | 2,942,813 | 2,342,500 |
| Less Current Portion | | (250,000) | (450,000) |
| | | 2,692,813 | 1,892,500 |

Note 3(a) - The demand loan is due and payable January 1, 1993 with interest payable monthly at prime plus 2.5%.

| Installment payments are due: | | |
|---|---|---|
| | July 1, 1992 | $100,000 |
| | Aug. 1, 1992 | 25,000 |
| | Sept.1, 1992 | 25,000 |
| | Oct. 1, 1992 | 50,000 |
| | Nov. 1, 1992 | 25,000 |
| | Dec. 1, 1992 | 25,000 |

The bank has indicated its intention to reschedule payment of the balance due on January 31, 1993 over a mutually agreeable term not exceeding three years.

3 continued

| | | |
|---|---|---|
| Subordinate debenture due Dec. 31, 1996 and is non-interest bearing, secured by a floating charge on the Assets of the Company (Note 3(b) | | 6,576,895 |
| Amended Subordinate Debenture | 4,701,011 | |
| | 4,701,011 | 6,576,895 |

Note 3(b) - The capitalization of interest and other fees on Jan. 31, 1992 increased the subordinated debenture to $7,201,011 of which $2,500,000 has been converted to common shares. The balance of $4,701,011 is due December 31, 1996 and is non-interest bearing unless the debenture is in default. Interest would then be payable monthly at an annual rate of between 4.5% and 9%, depending on operating results, until June, 1992 and at 10% thereafter. Principal repayment is required in increasing annual installments with additional payments required in the amount of 25% of operating cash flow and 30% of the proceeds of any treasury issue of common shares. The holder of the subordinated debenture also received 4,500,000 Special TCC shares carrying a fixed cumulative dividend as described in Note 4(c).

## (4) MINORITY INTEREST

| | | March 31 1992 | June 30 1991 |
|---|---|---|---|
| Convertible Preferred Shares of a TCC subsidiary - | Note (A) | --- | 2,057,501 |
| Treats Inc. U.S.A. Preferred - | Note (B) | 232,000 | 232,000 |
| Special shares of a Subsidiary issued 4,500,000 Shs. | Note (C) | 1 | --- |
| | | $ 232,001 | $2,289,501 |

(A) These shares represent TCC subsidiary's convertible preferred shares which were not acquired by Triadon Capital Corporation on July 9, 1990 and which were converted to TCC shares as part of the January 1992 reorganization, and subsequently exchanged for shares of Treats International Enterprises, Inc. (formerly S.L. Resources, Inc).

4 continued

(B) These shares are preferred shares issued by Triadon's U.S. subsidiary during the year ended June 30 1991 in connection with the acquisition of the U.S. franchise rights. The minority interest is convertible into 5% of the common shares of the U.S. subsidiary on a fully diluted basis. The Company may redeem the preferred shares for $250,000 any time after November 2, 1992.

(C) 4,500,000 Special Triadon Capital Corporation (TCC) shares, non-voting, retractable, with a yearly cumulative dividend in aggregate of $300,000 payable January 31 each year, with unpaid dividends increasing by a compound annual rate of 30% until paid. These shares are convertible into shares of Treats International Enterprises, Inc. (formerly SL Resources, Inc.) if the dividend and accrued interest are not paid in full by January 31, 1997, and may also be converted into shares or debt of Treats International Enterprises, Inc. (SLR) or TCC if the Company is in default under the amended terms of the subordinated debenture referred to in Note 3.

## (5) SHARE CAPITAL

(A) In July, 1989, the Company completed the sale of 7,000,000 Units provided for in its public offering, for gross proceeds of $630,000 US and a net, after deduction of expenses, of $527,839 US. The Company reserved 14,000,000 shares of common stock, $.001 par value, for conversion of the Class A and Class B redeemable common stock purchase warrants. On February 7, 1991, the Company declared a one for fifty reverse split of its common stock and warrants. In September, 1991, the Company rescinded this reverse split retroactively. These statements do not reflect these decisions, as they cancel out each other.

(B) Each Unit consists of one common share (par value $.001), and one Class A and one Class B redeemable common stock purchase warrant. Each redeemable Class A Warrant entitles the holder to purchase one share of common stock at $.09 US per share. Each redeemable Class B Warrant entitles the holder to purchase one share of common stock at $.12 US per share. On February 7, 1991, the Company and the Underwriter agreed to separate the common stock purchase warrants from the Units to allow them to be exercised. The Company reserves the right, in its sole discretion, to reduce the exercise prices of the warrants and to extend the exercise period. These warrants may be exercised at any time from the effective date of the prospectus until June 4, 1992, unless called prior.

5 continued

(C) The redeemable Class A and Class B common stock purchase warrants are callable by the Company any time prior to their conversion, with a notice of call in writing to the warrantholders of record, giving a 30 day notice of such call. The call price of the Warrants is to be $.0001 per Warrant. Any Warrant, so called, and not either converted, or tendered back to the Company by the end of the date specified in the notice of call, shall expire on the books of the Company and cannot be exercised.

(D) Provision is made in the Warrants for adjustment of the price and number of shares of Common Stock available for purchase in order to protect the holders thereof against dilution in the event of stock dividend, stock split, reclassification, reorganization, consolidation or merger. Holders of the Warrants, as such, will not have voting, dividend or other rights of stockholders of the Company unless and until their Warrants have been duly exercised and received by the Company's Warrant Agent, and then, only as holders of the obtained Common Stock.

(E) In connection with the initial public offering, the Company has reserved 700,000 Unit Options for sale to the Underwriter for a total price of $700. These Units are identical with those sold to the public, except that the offering price is $.108 US. The Company has reserved 2,100,000 shares of its common stock $.001 par value for exercise of the Units and conversion of the Class A and Class B redeemable common stock purchase warrants.

(F) In connection with the January 31, 1992 TCC reverse acquisiton of Treats International Enterprises, Inc. (formerly SL Resources, Inc), the Company has reserved 3,640,410 shares for sale to TriCapital Management Limited for the following consideration:

| | No of Shares | Consideration |
|---|---|---|
| Shares issued for nominal consideration April 17/92 | 765,306 | $ 1 |
| Share purchase Warrants @ U.S. $.105 - 3 Years | 1,360,104 | $ 142,810 |
| Share purchase Warrants @ U.S. $.15 | 1,000,000 | $ 150,000 |
| Share options @ U.S. $.0667 | 375,000 | $ 25,013 |
| $.105 | 140,000 | 14,700 |
| | 3,640,410 | |

5 continued

(G) SHARE CAPITAL

| | Post Acquisition Mar.31/92 | TCC the Continuing Co. Note (H) (I) | Audited June 30/91 |
|---|---|---|---|
| Class A participating shares: Unlimited number authorized 7,200,000 shares issued and outstanding | --- | | 1 |
| Class B common shares: Unlimited number authorized 6,450,000 shares issued and outstanding | --- | | 1,997,254 |
| Redeemable, convertible preferred shares: Unlimited number authorized 1,000,000 shares issued and outstanding | --- | | 1,000,000 |
| Debt conversion to common share equity (Note 3) | --- | 2,500,000 | |
| Non-Controling Interest converted to common share equity (Note 4) | --- | 2,057,501 | |
| P.Gibson | --- | 19,000 | |
| SLR Shares,Paid in Capital and Deficit | --- | 591,037 | |
| Share Issued Costs | --- | (186,107) | |
| Common Stock: 100,000,000 shrs authorized 37,500,000 issued and outstanding | 7,978,686 | --- | --- |
| | $7,978,686 | $4,981,431 | $ 2,997,255 |

(H) During the period ended March 31, 1992, Triadon Capital Corporation's share capital increased under a restructuring of the company's debt position as discussed in Note 3 and 4.

5 continued

(I) On January 31, 1992, Triadon's (TCC) shareholders exchanged all their shares, representing 100% of the outstanding shares of the Company, for 30,000,000 shares,which is 80% of the outstanding shares of Treats International Enterprises, Inc. (formerly S.L. Resources, Inc) .Under the provisions of the acquisition agreement, providing the company (SLR) receives a minimum of $1,000,000 in new financing by December 31, 1992, a number of shares will be issued or returned over the next three years should the Company exceed or fail to meet certain earnings targets, respectively. After giving effect to the exercise of the warrants as described in Note 2, the provisions of the acquisition agreements over the three year period ending June 30, 1995 will result in the former TCC shareholders controlling a maximum of 74% and a minimum of 40% of the outstanding common shares of Treats International Enterprises, Inc.

## (6) CONTINGENT LIABILITIES

The Company and its subsidiaries are defending civil litigation as indicated below.

Chocolate Gourmet Treats Limited is named in an action by a landlord claiming $200,000 for breach of a lease agreement. Management believes the Company has good defenses against this action. No provision has been recorded in respect of this action.

The Company is also defending several other actions arising in the normal course of business, the outcome of which cannot be determined at this time and for which no provision has been recorded.

The company has entered into certain agreements with creditors to reduce the outstanding accounts payable and to pay the agreed upon balance over a period of time, usually not on excess of 12 months. The renegotiated amount is reflected in accounts payable. As at this date, the company is fulfilling all terms of the agreements. In the event the company is not able to meet the terms of the agreement in the future, the creditors will have the ability to claim the full amount originally owed.

Any settlement in regard of the above actions in excess of amounts provided will be accounted for as a period adjustment.

# TREATS INTERNATIONAL ENTERPRISES, INC.

## (FORMERLY S. L. RESOURCES, INC.)

## 10-Q ITEM 2

## MANAGEMENT DISCUSSION

## AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In the quarter ended March 31, 1992 the Company has made great strides in its plan to reorganize it fiscal affairs and position itself for emergence in the United States market.

On January 31, 1992 a reverse acquisition was completed with S.L. Resources Inc., a Delaware company. This was the first step of the plan to restructure the debt of the Company. At the same time, our major subordinate debt holder converted 35% of their debt to equity and agreed to a non-interest bearing instrument for the balance of their outstanding debenture.

This transaction along with the balance of the restructuring is fully disclosed in the notes to the consolidated balance sheet of the Company.

System wide sales for the chain for the three quarters ending March 31, 1992 were $21,400,000 compared to $21,700,000 for the same period last year.

Area Development Franchises were sold for Central Florida and the Chicago areas. This brings the total number of stores committed to open in the United States to 103.

Total revenues for the third quarter were $1,091,066 compared to $1,090,223 for the same period last year. Revenue from royalties were up $43,790, representing a 10.5% increase, while revenue from franchising was up $126,500 (259.5%) compared to last year for the same quarter.

The growth in royalties and franchising revenue for the quarter was offset by a decline in other revenue of $169,447 or 27.2%. This was primarily the result of the Company's effort to dispose of Corporate store operations and to concentrate on franchising opportunities throughout North America. This, coupled with the fact that a nonrecurring payment by one of the Company's major suppliers to enter the United States market was made in the 1990-1991 fiscal year.

The operational revenues from royalties and franchising remained consistent with the last year at $1,394,000 and $417,600 respectively. In total, revenues declined $497,000 due to the closure and refranchising of corporated owned or managed stores. Combined with a non-recurring supplier credit which was included in the previous year's revenue.

Administrative costs and expenses have declined by $184,000 or 33.4% in the third quarter versus the same period last year. This is a direct result of management's mandate to centralize administration and streamline operations.

Corporate store expenses have been reduced $249,000 or 48.6% by reducing the number stores owned and managed by the Company. In addition, franchising and regional overheads declined by $102,000 or 41.5% which resulted from the reduction of the number of regional offices maintained by the Company.

Losses for the quarter were reduced to $64,931 from $720,700 for the same quarter last year. The nine month loss was $424,700 compared to $849,000 for the same nine month period of last year. As a result of the debt restructuring on January 31st, 1992, the average monthly interest cost of approximately $100,000 has been reduced to under $30,000 per month. The third quarter loss adjusted for pro forma interest savings would have produced a profit of approximately $145,000 in the third quarter.

The Company generated $247,000 in cashflow from operations during the quarter and $655,000 in cash from the restructuring and the reverse acquisition with S. L. Resources Inc. to finance working capital and pay down its operating facility with the bank.

The Working capital deficit has been reduced by $1,446,500 in the nine months ended March 28, 1992, however it currently remains in a negative position.

The Company has filed a prospectus with the U.S. Securities Exchange Commission ("SEC") on March 24, 1992 relating to 7,000,000 Class 'A' warrants and 7,000,000 Class 'B' warrants that, if exercised, will result in the issue of 14,000,000 common shares for cash consideration of (US) $1,470,000.

## TREATS INTERNATIONAL ENTERPRISES INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE STATEMENT OF INCOME

MARCH 31, 1992

| PART II | OTHER INFORMATION |
|---|---|
| Item 1 | Legal Proceedings - See notes to Financial Statements |
| Item 2 | Changes in Securities - None |
| Item 3 | Defaults Upon Senior Securities - None |
| Item 4 | Submission of Matters to a Vote of Securities Holders - None |
| Item 5 | Other Information - None |
| Item 6 | Exhibits and Reports on Form 8-K - None |

The information furnished herein reflects all adjustments which are, in the opinion of management, necessary to a fair statement of the results of operation for the period ended March 31, 1992.

The result of operation for the period ended March 31, 1992 are not necessarily indicative of the results of the entire year.

### Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TREATS INTERNATIONAL ENTERPRISES INC.
(formerly S.L. RESOURCES INC.)

By: ______________________________
Paul Gibson, Chief Executive Officer

By: ______________________________
David M. Dean, Chief Financial Officer

May 19, 1992